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Newsflash

PRA consults on how it expects banks and insurers to improve their climate risk management

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As communicated in its 2025 Dear CEO letter setting out regulatory priorities and the Regulatory Initiatives Grid, the PRA has published its Consultation Paper CP10/25 to update its supervisory expectations on enhancing banks' and insurers' approaches to managing the financial risks from climate change (Supervisory Statement SS3/19). That seminal SS catalysed regulatory advances globally on how banks and insurers are expected to manage prudential risk from climate change.

As a certified B Corp organisation, we[1] support the PRA's initiative to crystallise and make more granular how it expects UK banks and insurers to manage their climate-related risks. Done well, the update has the potential to strengthen the resilience of the UK financial sector to climate change, adaptation and policy changes, while minimising costs of complying with PRA expectations by focussing firms' efforts.

Some overarching thoughts for insurers

In our view, it is helpful that the PRA has spelt out its expectations of the Board, on risk management, on capital requirements and on regulatory balance sheets. This provides regulated firms with a clearer path to meeting prudential expectations on climate-related risks and helps ensure expectations are met.

The PRA makes a helpful distinction between climate risks which are already on the balance sheet today or associated with business expected to be written in the next year, and risks associated with business written after that period. Climate risks during the former time horizon need to be reflected in Solvency Capital Requirements (SCR) (and included in corresponding risk appetites where material). The PRA expects firms to articulate in detail what changes they might make to their business and business model, and when they would make decisions, for risks under the longer time horizon, being clear on the risk appetite for those risks.

While we recognise that the PRA is well intentioned in its desire for positive action on climate, the current proposals risk being perceived by many as the PRA overstepping its statutory objectives in seeking to deliver climate action across the economy through banking borrowers and insurance policyholders.

In some parts, the detailed expectations on the articulation of climate risk appetites, scenario analysis and risk management processes feel unduly prescriptive. It is unclear to us what this adds to existing requirements on risk management.

We found the governance (chapter 1 of the proposed SS), data (chapter 4) and specific chapters (chapter 6 for banking and chapter 7 for insurance) useful. However, the generic risk management and climate scenario analysis chapters (chapters 2&3) applicable to both banks and insurers felt too far removed from banking and

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[1] In addition, the author previously worked at the Bank of England as its Insurance Sector Actuary and contributed to the proposed policy, especially as it applies to insurers.

insurance risk to be relevant or insightful. We will recommend to the PRA that it issues separate banking and insurance supervisory statements when finalising expectations to maximise their effectiveness.

Unusually, the PRA has drawn attention to the proposals being expectations and not rules (Maintaining Momentum: Managing Climate risk in a changing world – speech by David Bailey). This may be both an implicit acknowledgement of the difficulty in managing climate risks and an explicit note that the proposals are guidance only. While there is leeway in implementing guidance, firms should bear in mind that supervisory interactions tend to follow guidance.

Summary of PRA proposals for insurers

	Summary of the proposed SS	Our initial view
Chapter 1: Governance	The PRA expects Boards to understand the impact of climate risks on the firm's business strategy under different climate scenarios and over different time horizons. As for other risks, Boards are ultimately responsible for setting the firm's risk appetite to climate risks and the PRA expects Boards to allocate sufficient time to consider climate risks. The PRA expects Boards to have the appropriate skills and experience to do so and to be able to exercise challenge. Boards are expected to ensure that the firm's strategy and risk management stays up to date.	Overall, these are sensible requirements that ensure Board are fully aware of how the firm is exposed to climate risks and are responsible for how these risks are being managed. The governance aspects are likely to already be broadly in place at most insurers. In the main, Boards have been upskilling in this area for the last few years. Insurers may wish to consider regular training for the Board, and more external perspectives, to keep up to date.
Chapter 2: Risk Management	The PRA proposes that firms have a clear risk appetite in respect of the material climate risks identified and that these are cascaded to individual lines of business. The PRA also proposes that firms consider the climate-related risks in relationships the firm has with its policyholders, *[reinsurers or derivative counterparties]* [2], borrowers, clients or investees whose assets they hold, with all material relationships subject to an individual assessment. [2] included in para. 4.7.21 of proposed SS.	Firms will have to articulate clearly what their climate related risks are and decide how best to articulate their risk appetites for their business. For some risks, it will be more appropriate to manage accumulations in aggregate across the business eg flood losses. Firms may wish to exclude some risks and exposures. Other risks may relate more to longer term business model risks that are outside the remit of business line management but should be considered in the firm's medium to long term strategy. Individually assessing the climate risk of all material policyholders or assets invested in feels overly intrusive. Risks assumed through insurance contracts (eg property, health or death in service) often differ to policyholders' climate risks and asset risks are often best managed on a portfolio basis. However, individual assessment feels sensible for major reinsurance or derivative counterparties.

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Chapter 3: Climate Scenario Analysis (CSA)	The PRA restates the need for Climate Scenario Analysis (CSA) in setting risk appetites, given the risk is not captured by historical experience. Firms are expected to be clear on the objectives of their CSA and the rationale for the range of scenarios selected, capturing risks to the firm's business model or that apply to the exposures they assume. The PRA expects firms to use different types of scenarios from narrative-based ones supplemented with expert judgement to the complex modelled scenarios under different emissions pathways developed by the International Panel of Climate Change (IPCC) or Network for Greening the Financial System (NGFS). Boards are expected to have an adequate understanding of their CSA, to be able to interpret outputs given context and caveats, and to understand how results are used in practice.	Rightfully, the PRA expects firms' CSA to demonstrably inform their business strategy. We suspect opinions will be divided on the utility of the Reverse Stress Testing (RST) that the PRA expects as part of CSA. RST can often yield valuable insights on what it needs to break a business (even if likelihoods are remote). On the other hand, many would argue that it is not credible that pooling of risk, asset management or lending would no longer be credible business models, even in those extreme climate scenarios firms are expected to consider.
Chapter 4: Data	On an ongoing basis, firms are expected to understand their data gaps and have remediation plans. Firms are expected to continuously improve their data and modelling capabilities, and to be able to scrutinise data and projections supplied by external providers, with an effective system of governance in place.	In general, this does, of course, make sense and aligns with broader data quality and external model policies. Some firms may find they have a slight gap in being able to scrutinise external data and models. However, the bigger challenge will be that climate data is not as abundant as for some other types of risk and that is not something that insurers can easily remediate.
Chapter 5: Disclosures	The PRA has not proposed any new regulatory disclosures on climate. The PRA expects banks and insurers to meet existing disclosure requirements for material risks and to engage with initiatives such as the UK Sustainability Reporting Standards. The PRA also highlights that it expects disclosures to evolve, that there are benefits to comparison across firms, and that firms are in a position to encourage wider disclosures across the economy.	It is positive that the PRA is not proposing additional prudential regulatory disclosures given the existing, and forthcoming, climate and sustainability disclosure requirements that insurers are already working on.

Chapter 7: Insurance specific issues

In this chapter, the PRA sets out its expectations of how climate-related risks impact risk management and risk appetites, Own Risk and Solvency Assessment (ORSA), SCR and the Solvency UK (SUK) balance sheet. The PRA recognises that climate-related risks could be a driver of underwriting, reserving, market, credit, liquidity and operational risks faced by insurers as well as reputational and litigation risks. In our view, the expectations in the chapter do not add new expectations but clarify how existing expectations apply to climate-related risks.

	Summary of the proposed SS	Our initial view
Risk Management	The PRA restates that it expects insurers to manage their exposures to stay within their defined risk appetites. The PRA makes clear the distinction between financial losses from exposures already in-force or to be assumed in the next 12 months (consistently with the SCR time horizon) and losses beyond that time horizon (including to a firm's business model and reputational risk). The PRA expects climate-related risks to be included consistently in risk modelling, scenario analysis and risk appetites to allow exposures to be managed effectively	The PRA proposals should encourage general insurers to take stock of whether climate is consistently and sufficiently reflected in their natural catastrophe modelling, scenario analysis and risk appetites used to manage exposures to peak and non-peak perils. Life insurers, and to a lesser extent general insurers, may find it useful to assess whether their current views of asset and credit risk, and corresponding risk appetites, need further adjustment for climate risk. For risks on a longer-term horizon, insurers should develop their analysis of how climate change, adaptation and policy change might impact their business models.
ORSA	The PRA makes clear that ORSAs should contain climate scenarios (unless the risk is demonstrably immaterial), considering the latest climate science and advances in modelling. It makes clear that where firms are using IPCC or NGFS scenarios, firms should build on the parameters and outputs of these global scenarios and make further assumptions to stress for the risks the firms face The PRA expects firms to articulate what management actions they would take (eg changes to underwriting or investment strategy), what MI they would monitor to inform those decisions and the trigger points for actions. The PRA also expects firms to consider litigation or reputational risks, including when insurers have made climate-related commitments or offer sustainability branded products.	By and large, insurers will already have climate scenarios in their ORSAs. Insurers will need to consider where the scenarios they currently use need to be further layered to stress their own risks (eg additional assumptions for flood or equity risk) and whether their range of scenarios is sufficiently complete (eg should scenarios of tipping points be included). Insurers will also need to invest time and resources to set out the underwriting, investment and other changes they might make in different scenarios, the trigger points for those changes, and the MI they will monitor going forward. A feedback loop will need to be established between commitments made on climate and sustainability and the consideration of litigation and reputation risk within ORSAs.

	Summary of the proposed SS	Our initial view
SCR	*Premium and reserving risk*: GI firms should consider whether their natural catastrophe component sufficiently factors in additional risks from climate change, both for peak perils and non-peak perils. The PRA also expects non-natural catastrophe modelling to capture potential climate litigation claims under liability insurances. Life insurers are expected to consider the impact of climate change on their mortality, morbidity and lapse rate assumptions. *Market risk:* Firms should consider that the distribution of future returns may be more variable than historical experience due to climate-related risks, with potential for greater variability in different sectors, subsectors or geographies. Where firms rely on Economic Scenario Generators, they should understand how climate-related risk has been factored in. *Counterparty credit risk:* Climate change may accentuate counterparty credit risk in those sectors or to those parties most exposed to climate risk. The PRA expects firms to ensure that their parameterisation of costs of downgrades, probability of default and loss given default reflects climate-related risks, where material. Where exposures are collateralised, the PRA expects firms to consider to what extent the underlying assets could be impaired. For major counterparties such as key reinsurers or derivatives counterparties, the PRA expects firms to engage with their counterparties to better understand the climate risk.	To the extent climate change leads to additional risk, this would already have been included in Internal Model SCRs or considered during Standard Formula SCR appropriateness. In our view, it is useful the PRA has spelt out the areas of the SCR calculation where they are expecting climate risks to be considered. The expectations are all sensible to our mind. It would be judicious for firms to ensure they have addressed the PRA views in their IM validation or in their SF appropriateness considerations.
SUK B/S	The PRA has not proposed any adjustment to market values or market consistent valuations on SUK balance sheets. As part of Matching Adjustment attestations, insurers are expected to consider the extent to which the Fundamental Spread (FS) is sufficient for retained risks including climate-related risks.	With SII and SUK being based on market consistent balance sheet valuations (bar the MA), the PRA's approach is not a surprise. MA attestations will now need to explicitly consider climate related risks in the sufficiency of the FS.

Next steps

We encourage our clients to respond to the **consultation closing on July 30** so the PRA can reflect on their views before finalising its expectations. We will hold a **hybrid** industry **roundtable discussion** for our clients on **June 12th at 4pm**. Please let us, or your usual contact at Hymans Robertson, know if you would like to join. For those coming to our **London office**, we would be delighted if you can stay for some drinks after.

Please do not hesitate to get in touch if we can help you with any aspect of this consultation – for example, a **gap analysis** against proposed expectations together with **a plan of action**, putting together **Board training**, **validating how your Internal Model** reflects climate-related risks, or supporting the **development** of the **climate scenarios** in your ORSA**.**

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