Newsflash

PRA finalises its expectations on how it expects banks and insurers to enhance their management of climate-related risks.

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The Prudential Regulation Authority (PRA) has now finalised its supervisory expectations of how banks and insurers should manage their climate-related risks (Supervisory Statement SS5/25). The new expectations supersede SS3/19 and consolidate previous PRA communications on this matter. We believe the industry will benefit from the PRA having clarified its policy and from the granularity of the policy. SS5/25 will make it easier for those insurers effectively managing climate-related risks to demonstrate and communicate this to the PRA.

What insurers need to do now

The expectations in SS5/25 **take effect immediately**. This is not totally surprising. From a PRA perspective, the policy is not intended to move regulatory goalposts or add new requirements but instead to clarify existing rules and expectations. Insurers are expected to **carry out a gap analysis** against the expectations **within 6 months** and put together a **"credible and ambitious" action plan** to address any gaps.

We encourage our insurance clients to be thorough in finalising their gap analysis. SS5/25 is granular in its level of detailed expectations on governance, risk management, climate scenario analysis, data and disclosures, with an insurance chapter setting out further detail on risk management, risk appetites, scenario analysis, Solvency Capital Requirements (SCRs) and Solvency UK (SUK) balance sheets.

The PRA's expectations are commensurate with a firm's exposures to climate-related risks and how climate might impact their business models. Simply put, firms with greater exposure are expected to do more. Many insurers will have carried out a significant amount of work to meet SS3/19 and they'll be able to leverage this work to largely meet the new expectations. Less well-prepared insurers exposed to climate-related risks will need to significantly up their game to meet the new expectations. However, even well-prepared insurers or those having invested significantly in the past in their climate capabilities will need to further develop their scenario analysis, better define their risk appetites to climate risk, and more robustly analyse the risks to their business models. We're aware that a number of the better prepared life and non-life insurers have been considering how to incorporate these capabilities since Consultation Paper CP10/25 came out in April.

What has changed on finalisation

Below are the most noteworthy changes or clarifications that the PRA made to the consultation paper. Policy Statement PS25/25 details how the PRA has considered responses to the consultation in finalising its policy.

Change or clarification	Hymans Robertson view
PRA confirmed that climate responsibilities can be **integrated within existing governance** frameworks	Climate is already well integrated in the governance framework of most insurers. It's positive that the PRA has accepted there is no need for separate governance arrangements for climate. This was a key area of discussion in our client interactions. We suggest insurers maintain a regular Board training and that Boards review the firm's climate exposures, strategy and plans annually.
PRA clarified that climate-related risks can be **integrated into existing risk registers**	Reassuringly, the PRA has made clear that there is no need to maintain a separate risk register for climate. Again, this was a key area of discussion with our clients. In our view, insurers will now need to fine-tune how they capture their climate-related risks and review their risk appetites against the new expectations. The PRA distinguishes between risks currently on the SUK balance sheet and those that are on a longer time horizon. It's likely firms will already have those climate risks currently on the balance sheet on their risk register together with a tolerance level for financial loss. Firms should now consider whether they have adequately factored in climate contributions to existing risks such as to natural catastrophe or climate litigation risks for non-life insurers, or to market or credit risk for life insurers, and should document their analysis. Risks on a longer time horizon are, by nature, less quantifiable and more qualitative. Firms may find it useful to think about longer term climate-related risks by considering reputational risks, business model risks and risks to their investment and underwriting strategies.
Recognition that **Climate Scenario Analysis (CSA) should be commensurate with risk** to the firm, with **Reverse Stress Testing (RST) no longer being mandatory**	Although Reverse Stress Testing (RST) can be a useful exploratory or communication tool, we believe it's been sensible of the PRA not to insist on climate RSTs and that firms' efforts are best focused on developing climate scenarios. Insurers may need to invest in developing their climate scenarios within their Own Risk and Solvency Assessments to meet expectations in SS5/25. Climate scenarios are expected to stay up to date with advances in climate science and understanding. When firms use Intergovernmental Panel on Climate Change and Network for Greening the Financial System scenarios, they're expected to build on these to stress their own risks. Some firms may wish to develop other scenarios. Insurers should consider how their underwriting strategy, investment strategy and business model might change in the long-term in different scenarios and set out what management information (MI) they'll monitor to inform decisions.

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Recognition that **litigation risk can be a transmission channel** for some firms	Non-life insurers writing Directors' and Officers', Professional Indemnity, and Financial and Professional lines may find it sensible to include a climate litigation scenario in their set of man-made catastrophe scenarios. This can be useful even if the net loss is not large to communicate the size of the exposure. Both life and non-life insurers may benefit from considering the reputational and financial loss of climate action against the firm and how these risks could materialise.
Clarification that the **current SCR rules are sufficient** to reflect climate-related risks	The PRA details in the insurance chapter its views of how climate can be a driver of risk in different components of Internal Model (IM) SCR such as natural catastrophes, man-made catastrophes, insurance risk, market risk and credit risk. Firms should ensure that their next IM validation takes these considerations into account.

How Hymans Robertson can help

We'd love to support you in your management of your climate-related risks.

Please get in touch if we can help with:

- Reviewing your gap analysis and action plan against expectations in SS4/25[1].
- Helping you further develop your climate scenarios.
- Helping you validate whether your IM sufficiently takes into account climate risks.
- Preparing your Board training or facilitating a Board session.
- Anything else.

Our Insurance and Financial Services (IFS) practice combines the resources and expertise of our life insurance and general insurance teams, and leverages the resources and expertise of the Hymans Robertson's Responsible Investment team. We use decades of experience, including in sustainable investment, to advise on both sides of your balance sheet. We provide a personalised service delivered by highly experienced actuaries with deep expertise in their fields and your interests always at heart.

[1] The first author previously worked at the Bank of England where he led the development of CP10/25 as it applies to insurers.