Consultation Paper 10/25: Enhancing banks’ and insurers’ approaches to managing climate-related risks

Update to Supervisory Statement 3/19

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Consultation Paper (CP) 10/25 sets out the Prudential Regulation Authority's (PRA’s) proposals for updated supervisory expectations regarding how insurers (and banks) should manage climate-related risks. It proposes a new draft Supervisory Statement (SS) to replace SS3/19, aiming to provide greater clarity and detail compared to the previous high-level direction.

While SS3/19 had four areas of expectations, the proposed SS is structured into seven chapters to reflect the more detailed expectations: governance, risk management, climate scenario analysis (CSA), data, disclosures, banking-specific issues and insurance-specific issues.

The proposed expectations are intended to provide more-detailed help to insurers to manage the effects of climate change on their businesses and maintain the essential services they provide. The approach is designed to be applied proportionately, scaling to the risks a firm is exposed to; firms materially exposed to climate-related risks would need to take greater action. The proposals build on SS3/19, incorporating lessons learned, feedback from industry, previous PRA guidance and new international standards. With the exception of the disclosures section of the proposed SS, the vast majority of the requirements detailed in this summary are ‘new’ requirements, i.e., they were not required under SS3/19.

CP10/25 proposals

GOVERNANCE

The proposed rules require:

- The board to set and own the overall business risk appetite for climate
- Coherence between a firm’s overall strategy and any climate targets the firm has adopted
- Management bodies to provide the board with relevant, specific, and decision-useful information
- Firms to provide the board with appropriate training on climate-related risk
- Management responsibility for identifying and managing climate-related risks to be assigned at an appropriate level of seniority, with clear reporting lines and accountability, potentially linked to the firm’s appraisal and reward system
- The board to be provided with an analysis of the performance of the firm’s business strategy under a range of climate scenarios
- Boards to set risk appetite and tolerance levels for outsourced and third-party arrangements that may be exposed to, or introduce, climate-related risks
- Incorporation of climate-related risk into internal control frameworks across the three lines of defence

The governance proposals aim to remediate issues that the PRA has observed to date, such as information provided to boards often being unclear and insufficiently specific and a lack of analysis of the impact of climate-related risks on business strategy.

Establishing climate-specific risk appetite statements for any material climate-related risks is an additional requirement introduced in the new draft SS, and this is likely to be an area where further consideration is needed by many firms. The explicit requirement to incorporate any climate targets with the firm’s overall business strategy is also newly introduced and should help to promote consistency between climate-specific targets such as net-zero goals with wider business practices.

RISK MANAGEMENT

- Firms should periodically carry out structured risk identification and assessment to identify material risks and classify them, substantiating any materiality judgements made within the Own Risk and Solvency Assessment (ORSA).
- Insurers should undertake a risk assessment of climate-related risks arising from relationships with policyholders, clients, counterparties, and investees, for 'material relationships'—relationships that have a material impact on the climate-related risk profile.
- Firms should develop quantitative risk appetite metrics and limits for each material risk, informed by scenario analysis and reverse stress tests.
- An appropriate internal risk reporting infrastructure should be developed. Examples of management information (MI) include utilisation of risk appetite limits, changes to the risk register and analysis of the financial impact of climate events.
- Firms should assess the impact of climate-related risk drivers on their operational resilience, considering severe but plausible scenarios.

Operational resilience is not referenced in SS3/19, and therefore the proposed requirements, if approved, will require firms to undergo an exercise to ensure that their business continuity plans and disaster recovery adequately cover potential climate-related risk scenarios.

The new draft SS also introduces more-detailed requirements around quantitative metrics, prompted by the PRA's observation that firms face challenges establishing metrics which can meaningfully inform decisions. However, the PRA does not propose specific metrics, as the appropriateness of specific metrics will vary across firms.

CSA

CSA is a key risk assessment tool supplementing standard approaches, as standard stress testing is not suitable for the non-linear nature of climate-related risks.

- Firms must document how CSA informs decision making and be able to justify scenario selection.
- Firms should select, match and tailor scenarios to their CSA objectives, exploring a range of plausible ('central case') future outcomes, and then adjusting the intensity for climate tail risks.
- Firms should be aware of the limitations of the climate scenarios and models they use and account for these limitations in their use of results. Lack of capture of 'non-linearities and potential tipping points' are referenced as specific limitations to be accounted for.
- Firms should have a structured approach to assessing each component of a quantitative CSA's model chain.
- CSA should be used proportionately for purposes such as setting strategy, risk appetite, internal capital setting and assessing impacts on liquidity, solvency and their ability to pay policyholders.
- Firms should include CSA as part of their ORSA, and this should include reverse stress tests.
- Where a firm cannot conduct an appropriate CSA, or decides not to develop advanced CSA capabilities, it should demonstrate an alternative approach to understand future climate-related risks.
- Firms should regularly review and update scenarios.

The proposals indicate the need for more-detailed CSA, with firms being required to select, match and tailor scenarios for a range of different use cases. This includes consideration of multiple time horizons, objectives and levels of severity depending on the use case. Table 1 in the proposed SS contains an example of types of use cases and the appropriate corresponding time horizons, frequency and calibration. This could form a useful starting point for firms to consider expanding their CSA plans and use cases.

The proposals also introduce an explicit new requirement for reverse stress testing and specify that more-granular analysis by geography, sector and counterparty is required for risks identified as material and for which the firm has chosen to manage rather than avoid.

DATA

- Data gaps remain a significant challenge. Firms should be able to explain how they identify and assess data gaps. Where reliable data is not available, contingency solutions, e.g., conservative assumptions and proxies, should be used.
- Insurers that rely on external data should have an effective system of governance and plan strategic development of in-house capabilities.
- Firms should have systems to collect and aggregate climate-related risk data.

The proposals place responsibility on firms to work on developing their in-house data capabilities going forward rather than simply accepting the limitations of external data—this represents an evolution of climate-related risk management with a focus for firms to start to consider addressing current limitations.

DISCLOSURES

The PRA is not proposing substantive changes to the disclosure expectations in SS3/19. A change is proposed to replace the reference to Task Force on Climate-related Financial Disclosures (TCFD) recommendations with a reference to UK Sustainability Reporting Standards, a framework established by the UK government which is based on global standards developed by the International Sustainability Standards Board (ISSB). Any formal amendments to UK sustainability disclosure requirements are subject to consultation by the Financial Conduct Authority (FCA), once the process for UK endorsement of ISSB is sufficiently advanced.

INSURANCE-SPECIFIC ISSUES

Proposals clarify expectations for inclusion of climate-related risks in the ORSA, in the calculation of the Solvency Capital Requirement (SCR) and in preparing the Solvency II balance sheet.

- Climate-related risks should be reflected in the risk management framework and in risk appetite statements; this ensures that existing risk appetites for natural catastrophe, etc., do not underestimate climate change impact.
- Integrating climate scenarios in ORSA is required when climate-related risks are material.
- Insurers should detail the investment and underwriting changes they would make in response to climate-related risks, which is particularly relevant for non-life insurers regarding underwriting (e.g., reducing coverage or repricing). Metrics should be specified to inform decisions on the changes.
- Insurers using an internal model (IM) to calculate their SCR should consider the impact of climate-related risks on underwriting, reserving, market, credit and operational risk components of their IM. Insurers using the Standard Formula (SF) should consider the impact of climate-related risks as part of the assessment of SF appropriateness. However, no new additional capital requirements beyond those required by the PRA's Solvency II SCR rules are being imposed, as the PRA considers the existing regulatory framework to be sufficiently comprehensive to cover climate-related risks implicitly.
- The Solvency II balance sheet should reflect climate-related risks:
  - Asset values are calculated on a market-consistent basis, and therefore no adjustment should be required for liquid traded assets or those with a directly observable market price. However, adjustments may be required where there is no active market for the asset.
  - For life insurers, best estimate mortality, morbidity, lapse and expense assumptions used to calculate liabilities should be appropriate given the potential impact of climate change.

Conclusion

The CP states that these proposals aim to improve the resilience of firms to climate-related risks by providing a more rigorous and coherent approach. It is certainly a step forwards in the evolution of climate-related risk management and, once approved, will set a new standard for firms to attain.

The consultation closes on Wednesday, 30 July 2025.

Please reach out to the authors or your usual Milliman contacts if you would like to discuss the implications for your business.

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