

What UK pension funds could learn from the CP10/25 Draft Statement on ‘Enhancing banks’ and insurers’ approaches to managing climate-related risks’

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Whilst not directly applying to pension funds, the granularity of expectations in Consultation Paper (CP) 10/25—particularly in risk assessment and climate scenario analysis—has leverageable best practice insights for UK pension funds. There is an implicit anticipation of a repricing of climate-related risks. Pension funds should consider if they have already addressed this or risk being ‘last in the queue.’

The Prudential Regulation Authority’s (PRA’s) Consultation Paper 10/25 ([CP10/25](#)) updates [Supervisory Statement \(SS\) 3/19](#), the foundational framework seeking to embed climate-related risk awareness into insurers’ and banks’ governance and risk management. It proposes far greater prescription and is focused on outcome-driven results, demanding operational integration of climate-related risks into their capital, strategy and decision-making. As a consultation, the statement may change; however, such statements do not typically change significantly, and the draft provides insights into regulators’ thinking and the likely direction of industry efforts.

One reading of this new draft is to consider climate-related risks such as having moved from a novel, emerging risk to an endemic, emerged risk which needs to be integrated into decision-making across the whole of the business. There is an implicit paradigm shift to see climate-related risks as a core driver of business resilience, to recognize the need to demonstrate evidence of action over policy compliance and to explicitly require embedding dynamic adaptation that allows for updates in science, geopolitics and markets.

CP10/25 is certainly more granular and detailed (133 paragraphs in total) than equivalent UK pension fund regulation covering climate-related risks. In particular, the areas on risk assessment and climate scenario analysis (CSA) reflect emerging best practices that may be beneficial for pension funds to consider. There are also broader elements of governance, management and reporting within the CP that may also interest those seeking to align with best practices.

RISK ASSESSMENT

There is much detail in the risk assessment paragraphs. Particular attention is paid to:

- **Risk identification and assessment:** Taking a holistic approach with attention to the whole firm and inclusive of liquidity, operational, third-party aspects and the impacts of legal liability risks.
- **Non-financial risks:** The attention to non-financial risk may be particularly interesting to pension funds, especially for those that are still open or considering ‘run-on.’ These include the risks arising from relationships with clients, counterparties, investees and policyholders (including their physical adaptation and transition risk plans), alongside liquidity risks and operational resilience.
- **Risk measurement, monitoring and reporting:** Guidance is not only given on the risk register, risk appetites and risk categorisations but also on climate-related risk metrics, limits, triggers and suitable reporting.
- **Dynamism:** The need for periodic review, based on latest scientific evidence and going beyond historical data.

From a pension fund point of view, these risk assessments should be considered within an Integrated Risk Management context, considering these impacts across assets, liabilities and sponsor covenant.

CLIMATE SCENARIO ANALYSIS

There are extensive expectations laid out for both the detail and application of CSA. Of particular note are the expectations:

- **To select, match and tailor scenarios** aligned to the specific CSA objectives, exploring a range of plausible (‘central case’) future outcomes, and then adjusting the impact intensity for climate tail risks.
- **For awareness of the limitations of the climate scenarios and models they use** and account for these limitations in their use of results. Not capturing ‘non-linearities and potential tipping points’ is referenced as a specific limitation to account for.
- **For a structured approach to assessing each component** of the complex chain of models that typically underlie quantitative climate scenarios (such as NGFS or IPCC) model chain.

- **For additional data governance** requirements, examining the dependency on external providers (contained within an explicit section on 'Data' in CP10/25).
- **To use CSA within setting strategy, risk appetite and internal capital setting** and assessing impacts on liquidity, solvency and the ability to pay policyholders.
- **To undertake reverse stress tests.**
- **To regularly review and update scenarios.**

Further, there is a proposed requirement to document how CSA informs decision-making and to justify scenario selection for its different use cases.

LEARNINGS, RISKS OF MARKET REPRICING AND ACTIONS

For insurers, significant work will be undertaken, starting with a gap analysis and then a systematic work-through of the requirements, if the CP is implemented as proposed.

From a broader perspective, there is also an interesting comment in §4.43 of the consultation on potential pricing adjustments. Whilst the PRA doesn't expect 'shocks to the financial system,' it *'expects that firms will require [varying amounts of] time to implement the proposals...and more likely that climate-related risk becomes priced in somewhat gradually.'* This illustrates the potential for the repricing of climate risks across the insurance and banking sectors, which opens the question of whether pension funds would want to be first or last in that repricing queue.

Thus, five potential learnings for UK pension funds from CP10/25 are:

1. **Call to action:** Inaction risks making funds the 'last in the queue' for these risk repricings unless funds are already confident they have addressed these repricing impacts.
2. **Review risk assessment:** Undertaken within a holistic, integrated risk management framework with attention to non-financial risks, including reliance on third parties.
3. **Upgrading CSA:** This should be done with particular attention to central cases, model assumptions and data governance, and include considerations of tipping points and non-linearities, reverse stress tests, and applying scenario efforts both to financial and non-financial risks.
4. **Ensure decision-making integration:** Review (or upgrade) internal reporting, metrics and governance with an emphasis on decision-making actions over policy compliance.
5. **Embed dynamism:** Threaded throughout the draft statement is the need to continually review efforts based on latest scientific evidence, industry practice and going beyond historical data.

CP10/25 sets out the PRA's expectations for Insurers and Banks. The distinctive lens provides an interesting cross-comparison for pension funds to consider their own efforts. What's more, its potential to generate a repricing of climate-related risk creates a call to action for pension funds to review their position and ensure they aren't left 'last in the queue.'

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FURTHER READING ON CP10/25

[Summarising Consultation Paper 10/25: Enhancing banks' and insurers' approaches to managing climate-related risks](#)

[Key Issues and implications from CP10/25: Enhancing banks' and insurers' approaches to managing climate-related risks—update to SS3/19](#)

[Is your firm's approach to climate scenario analysis in line with the proposed UK regulations?](#)