



Principles for the effective management of climate-related financial risks – a comparison with the existing UK regulation

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Addressing climate risk is a key agenda item of the Basel Committee on Banking Supervision (BCBS). In June 2022, the Committee issued principles¹ for the effective management and supervision of climate-related financial risks aiming to improve practices of banks and supervisors. These principles represent the culmination of work on climate-related financial risks by the Committee over the past few years.

The Committee has stated that it expects these principles to be implemented by the authorities as soon as possible. With the Bank of England being a member of the BCBS, this article will seek to explore how these principles could impact existing UK regulation and how banks should address climate-related risks.

February 2020

The Task Force on Climate related Financial Risks (TCFR) was created by the Committee to conduct work on climate-related financial risks.

April 2020

The Stocktake report was published by the TCFR on the Committee members' existing regulatory and supervisory initiatives on climate-related financial risks.

April 2021

Analytical work conducted to better understand the risk features of climate change and its potential implications for individual banks and the broader banking system, leading to the publication of two reports:

- 1) Climate-related risk drivers and their transmission channels
- 2) Climate-related financial risks - measurement methodologies.

November 2021

A consultative document was published outlining a principles-based approach to improving risk management and supervisory practices related to climate-related financial risks.

June 2022

Principles published for the effective management and supervision of climate-related financial risks by the Committee, with members informed that it expects these principles to be implemented by the authorities as soon as possible.

1. <https://www.bis.org/bcbs/publ/d532.pdf> - Principles for the effective management and supervision of climate-related financial risks (bis.org)

The principles cover the following key areas:

- 1 **Corporate governance** – includes understanding the impact of climate-related financial risks on strategy, climate-related roles and responsibilities and firm-wide policies and procedures
- 2 **Internal control framework** – the incorporation of climate-related risks into the internal control framework across three lines of defence
- 3 **Capital and liquidity adequacy** – consideration of climate-related financial risks on capital and liquidity assessment processes
- 4 **Risk management process** – banks should ensure that their risk appetite and risk management frameworks consider all material financial-related risks to which they are exposed to
- 5 **Management monitoring and reporting** – risk data aggregation capabilities and internal risk reporting practices should account for climate-related financial risks, with the ability to produce timely information for senior management
- 6 **Comprehensive management of credit risk** – consideration of the climate-related risk impact on credit risk profiles

- 7 **Comprehensive management of market, liquidity, operational and other risks** – consideration of the climate-related risk impact on market, liquidity, and operational risk as well as other risks including strategic, reputation and regulatory compliance risk
- 8 **Scenario analysis** – used to test the resilience of business models and strategies against a range of climate-related pathways

The principles seek to outline a common baseline for internationally active banks and supervisors, whilst also accounting for the differences in sizes of the banks and banking sectors that the supervisors cover.

The Committee has stated that it expects these principles to be implemented by the authorities.



UK banking regulation and climate-related risks

“Ensuring the financial system is resilient to climate-related risks” is top of the Bank of England’s climate agenda. In April 2019, the Prudential Regulatory Authority (PRA) issued a new supervisory statement, SS3/19, enhancing banks’ and insurers’ approach to managing the financial risks from climate change², setting a deadline of the end of 2021 for firms to have embedded them as far as possible.³

The PRA’s expectations can be split into four key areas:

- 1 **Governance** – embed the consideration of the financial risks from climate change in their governance arrangements
- 2 **Risk management** – incorporate the financial risks from climate change into existing financial risk management practice
- 3 **Scenario analysis** – use (long term) scenario analysis to inform strategy setting and risk assessment and identification
- 4 **Disclosure** – develop an approach to disclosure on the financial risks from climate change

The PRA's SS3/19 BCBS' principles

With the PRA’s SS3/19, published in April 2019, being a cornerstone of UK banking regulation on managing climate risk, a comparison of this supervisory statement with the BCBS’ principles will help assess if there is a case for updating UK regulation.

| Governance

Overlap between SS3/19 and BCBS’ principles

- Incorporation of climate-related risks into the bank’s strategy
- Clear roles and responsibilities defined for identifying and managing climate-related financial risks
- Training of senior management on climate related risks
- Longer term planning horizons
- Oversight of controls

2. <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2019/ss319>

3. <https://www.bankofengland.co.uk/climate-change>



BCBS' additional / more explicit requirements

- Assessment of whether impact of material climate-related financial risks into the bank's overall business strategy and risk management frameworks may warrant changes to its compensation policies
- The climate risk approach should be clearly communicated to the bank's managers and employees

- Metrics should be updated regularly to support decision making by the firm's board and/or relevant sub-committees, with use of proxies where data is not available
- Engagement with clients and counterparties and collecting additional data to better understand their transition strategies and risk profiles

Risk management

Overlap between SS3/19 and BCBS' principles

- Climate-related financial risks addressed in the bank's risk appetite framework
- Use of scenario analysis and stress testing
- Firms should also use these metrics to monitor progress against their overall business strategy and risk appetite

BCBS' additional / more explicit requirements

- Concentration risk – posed by industry, economic sectors and geographic regions
- Comprehensive requirements for management of credit, market, liquidity and operational risk
- Explicit requirements for management of other non-financial risks such as strategic, reputational and regulatory compliance risks
- Communication of the limitation that prevents full climate risk data assessment should be made explicit to stakeholders



Scenario analysis

Overlap between SS3/19 and BCBS' principles

- Use of scenario analysis to inform strategic planning and determine the impact of the financial risks from climate change on their overall risk profile and business strategy
- Scenario analysis should also be used to explore the resilience and vulnerabilities of a firm's business model to a range of outcomes
- Expectation of approaches to scenario analysis to evolve and mature over time
- Employment of a range of time horizons

BCBS' additional / more explicit requirements

- Larger and more complex banks should be expected to have more advanced analytical capabilities
- Banks should consider the potential benefits and limitations of scenarios and assumptions

Internal controls framework

Overlap between SS3/19 and BCBS' principles

- Board oversight of controls

BCBS additional / more explicit requirements

- Clear definition and assignment of climate-related responsibilities and reporting lines across the three lines of defence

Capital and liquidity adequacy

Overlap between SS3/19 and BCBS' principles

- Incorporation of climate-related financial risks into capital adequacy profile
- An assessment of how firms have determined the material exposure(s) relevant to the business

BCBS' additional / more explicit requirements

- The PRA defines minimum requirements whilst the BCBS expects an iterative and gradual progress to incorporating climate related risks into capital adequacy profiles
- Requirements for liquidity assessments

Reporting / disclosure

Overlap between SS3/19 and BCBS' principles

- Internal reporting systems are capable of monitoring material climate-related financial risks and producing timely information to ensure effective board and senior management decision-making

NB: whilst the PRA expects firms to consider the 'Taskforce on Climate-related Financial Disclosures' (TCFD) framework and other initiatives (e.g. new International Sustainability Standards Board (ISSB) standards) in climate-related financial disclosures, there is no mention of disclosure expectations in the BCBS' principles.

Conclusion

Having analysed both the PRA SS3/19 and the BCBS' principles, it's clear that both are largely consistent with each other, however, there are some additional requirements for the UK regulatory environments that stemmed from the BCBS principles.

This includes compensation policies, different expectations for banks depending on size and assignment of climate-related responsibilities and reporting lines across the three lines of defence.

The BCBS' principles also provide granular guidance to help banks address climate risk, for example metrics or heatmaps are suggested as tools to monitor concentration of exposure to higher climate-related risk. The BCBS principles do not cover climate disclosure requirements.

The TCFD framework is the current framework for the disclosure of sustainability-related financial information and is mentioned in the PRA's SS3/19.

However, the ISSB created at COP26, is working on new requirements based on the TCFD framework. Once these requirements are finalised, they will define how banks and other entities should disclose sustainability-related information and are expected to replace the TCFD framework.⁴

When considering the PRA SS3/19 and the BCBS' principles it is important to note that SS3/19 was developed earlier (in April 2019), and since then there have been significant developments in the management of climate risk, which enable the requirements to be more complete and guidance to be more detailed.

With climate risk firmly on the agenda of the boards of banks and regulatory / supervisory bodies, best practices and regulations are expected to develop over the coming years. Our team of risk, regulatory and compliance experts can help ensure your risk team remain dynamic and compliant.

4. <https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf>



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- Cards and payments
- Retail and commercial banking
- Capital markets
- Finance
- Risk, regulatory and compliance

We take pride in building relationships with our clients and we work collaboratively to drive change for a bigger and better future.

The risk, regulatory and compliance team at **Be UK** is composed of specialists and advisors. Our key service areas include:

- Enterprise risk management
- Recovery and resolution planning
- Capital management and optimisation
- Financial crime
- Operational risk and resilience
- Sustainability, ESG and climate risk

Contact

For more information on how we can help with your ESG, climate and risk initiatives, please get in touch.



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With many years of experience in the international financial services industry, Alessandro has a wealth of experience in risk, regulation and compliance, gained through international roles, both as a consultant as well as a banker, including CRO roles in the UK and CH. His experience ranges from strategy and governance, AI / ML risk applications, risk transformation, system implementations to compliance and regulatory assurance.

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