



THE CLIMATE FINANCIAL RISK FORUM GUIDE 2020





The Climate Financial Risk Forum (CFRF) was established by the UK Prudential Regulation Authority (PRA) and the UK Financial Conduct Authority (FCA) in early 2019. The CFRF is an industry-led forum (the forum), bringing together senior representatives from across the financial sector to produce practical tools and recommendations for firms in responding to climate-related financial risks and capturing the opportunities arising from climate change.

Following the establishment of the CFRF, the group published its first Climate Financial Risk Forum Guide (the guide) on the 29 June 2020. A link to the full guide summary can be found [here](#).

Membership of the Forum

Membership consists of asset managers, banks and insurers, with trade bodies observing and feeding in the views of a wider range of firms.

The forum was split into four distinct Working Groups covering:

	<p>Risk Management</p>	<p>By appropriately embedding climate-related financial risk into its governance and risk management processes a firm can make informed business decisions and improve its resilience.</p>
	<p>Scenario Analysis</p>	<p>By appropriately modelling and considering a range of potential futures, a firm can better understand and manage future risks today, whilst capturing opportunities to support the transition to a net-zero carbon economy.</p>
	<p>Disclosures</p>	<p>By making effective climate-related financial disclosures, a firm can improve transparency regarding the impact of material financial risks from climate change on their business, helping the market appropriately assess the true future value of assets.</p>
	<p>Innovation</p>	<p>By developing novel products, services, policies and approaches a firm can adapt its business to respond to the potential impacts of climate change, benefit consumers and deliver the change required to meet climate goals.</p>

Each of the topics above is covered in detail with a separate chapter, accessed via a hyperlink within the summary guide itself.

The forum states that the intention of these four distinct chapters is to help financial services firms understand how they can approach these topics, where they could start and to highlight gaps and barriers. The guide provides practical tools, experience, knowledge and case studies developed 'by industry, for industry', which firms can learn from as they develop their strategies, processes and approaches.

The guide recognises that there are distinct interests, priorities and issues for different classes of financial institutions and highlights key points for the various sectors including where different approaches are appropriate (i.e. recommendations are either general or financial sector-specific).

The guide further states that the chapters are designed to be complementary to existing frameworks and initiatives, such as the UN-supported Principles for Responsible Investment (PRI), Principles for Responsible Banking (PRB) and Principles for Sustainable Insurance (PSI) and the Taskforce on Climate-related Financial Disclosures (TCFD).

The guide recognises the concept of proportionality i.e. that firms of different sizes, or of differing levels of expertise and experience in considering climate-related financial risks, may take different approaches. For example, larger firms with greater resources, which have been actively considering climate-related financial risks, may take more advanced and comprehensive approaches than smaller firms, which may be new to these topics.

However, the guide says it is important to note that the approaches taken by firms will be proportionate to the climate-related risks they face. For example, a small firm with large exposure to climate risk due to geographic or sectoral concentration may have to implement a more sophisticated climate risk approach than a much larger firm with less exposure. The chapters provide advice on how to take proportionate approaches to help tackle these challenges.

The guide says that practitioners will judge what a proportionate application of the guide's recommendations means for their firm. The separate Working Groups recognise that embedding climate risk management is a multi-year endeavour and the chapters indicate where firms can make a start and then develop their approach over subsequent years.



Risk Management

This chapter looks at the following categories:



The guide comments:

This chapter should be read in conjunction with the PRA's [SS3/19](#), the FCA's requirements for solo-regulated firms including consideration of how external factors can impact on strategy and viability as discussed in [CP19/20](#) and the Scenario Analysis and Disclosure chapters.

This chapter outlines recommendations from the Working Group, including how firms can approach designing and implementing a governance approach for climate risks akin to that used for established financial risks, while addressing climate risk-specific nuances. It discusses how firms can decide whether to treat climate risk as a standalone or as a cross-cutting risk and then integrate climate risk into existing risk management frameworks, recognising how the linkages between climate risk and established risk types may be identified and understood.

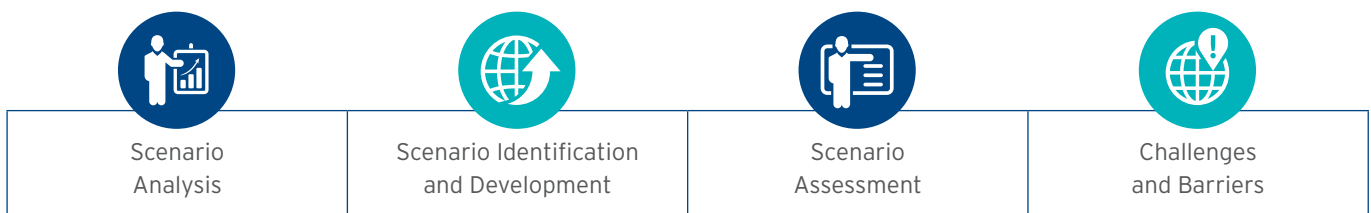
The chapter notes that, in addition to the standard planning cycle, climate change impacts should be considered over a longer period e.g. 30 years, with interim milestones. It recommends that a mature risk appetite considers scenario analysis and impact assessments or trend analysis.

The Working Group demonstrates that risk assessment of financial and non-financial risks is essential to identify measure, monitor and mitigate the risk within an institution's appetite. Detail is provided on the most material and applicable risk types relating to climate across the financial sector, namely insurance underwriting, credit, operational and financial market risks.

Link to full Risk Management chapter can be found [here](#).

Scenario Analysis

This chapter looks at the following categories:



The guide comments:

This chapter should be read in conjunction with [SS3/19](#), and with outputs of the PRA's 2021 Biennial Exploratory Scenario ([BES](#)), the FCA's requirements for solo-regulated firms including [CP19/20](#) and requirements around scenario analysis in the Prudential sourcebook for investment firms (IFPRU), and the Network for Greening the Financial System (NGFS)'s publication on scenario analysis and reference scenarios.

The end-to-end climate scenario analysis process is iterative. The results from identifying potential exposures should inform the scenario development process, which in turn should determine the key assumptions used in the assessment of the financial impact of that scenario. Insights

gained from that financial impact analysis should in turn feed back into the refinement and identification of new risks and potential exposures and inform the on-going development of existing scenarios as well as supporting identification of potential new scenarios to be analysed.

The Working Group recognises there are many challenges and barriers to overcome in performing scenario analysis in particular the breadth and magnitude of the effects of climate change, the extended time horizons, uncertainty and lack of recent historic precedents.

Link to full Scenario Analysis chapter can be found [here](#).

Disclosures

This chapter covers the following topics:

						
Key messages for approaching good practice climate-related financial disclosures	Disclosures on governance and strategy	Disclosures by asset managers	Disclosures by banks	Disclosures by insurers	Suggested timeline to implementation	Gaps and barriers

The guide draws on good practice examples from industry as well as guidelines set by relevant and respected industry bodies, including the recommendations of the TCFD.

The recommendations in the chapter are based on the seven principles for effective climate-related financial disclosures set out in the TCFD recommendations, namely that disclosures should:




- Represent relevant information;
- Be specific and complete;

- Be clear, balanced, and understandable;
- Be consistent over time;
- Be comparable among companies within a sector, industry, or portfolio;
- Be reliable, verifiable and objective; and
- Be provided on a timely basis.

Link to full Disclosures chapter can be found [here](#).

Innovation

Included in this chapter are topics which look at:

	Possible approaches to match the sources of finance and pools of capital against potentially investable assets and technologies, to identify and enable pathways for investment.
	The role of data innovation to improve the quality and availability of information that facilitates the effective allocation of capital.
	Practical measures that financial institutions can take to address this mobilisation of finance to tackle climate targets.

In addition, the chapter outlines a number of recommendations:

- Developing new investment vehicles and products (e.g. transition bonds and emerging market green infrastructure funds) to enable deployment of assets into developing and emerging transition and net-zero markets.
- Building local partnerships between finance institutions, local authorities and other public sector bodies to support development of investable, net-zero carbon projects, building on clear national policy frameworks for net-zero ambitions.
- Improving the quality and consistency of climate-related data to enable markets to better quantify the risks and opportunities, and then act on them. For example, by developing common principles and good practice for sector-wide data sharing, building on those for open banking and open finance.

Link to full Innovation chapter can be found [here](#).



Ongoing Work

The CFRF will maintain relevance and leverage industry learnings by continuing to deliver new material on topics that progress the management of climate-related financial risks and opportunities. The Forum will also be reaching out to get wider views on the issues that firms face and areas where the recommendations could be adapted to make them more practical and usable. These insights will feed into the ongoing work of the CFRF.

The Forum is currently planning the agenda for its second year, which will leverage opportunities to coordinate or complement wider work in finance on climate change at national and international levels.

The Forum says it can also act as a point of contact for other related national and international industry initiatives and ensure that efforts progress capability industry-wide, avoiding duplication of effort.

Dear CEO letter

On 1 July 2020, the PRA issued a [Dear CEO letter](#) in which it states that firms should have fully embedded their approaches to managing climate-related financial risks by the end of 2021. By this time the PRA says that firms should be able to demonstrate that the expectations set out in 'Supervisory Statement 3/19: Enhancing banks' and insurers' approaches to managing the financial risks from climate change' (SS3/19) have been implemented and embedded throughout their organisation as fully as possible. In doing this, firms should take a proportionate approach that reflects their exposure to climate-related financial risk and the complexity of its operations.

The PRA also discusses its observations from its thematic review of firms' SS3/19 plans. It has found that most firms have made good progress in developing approaches to identify, assess, manage, report and disclose climate-related financial risks and have started to embed them in associated governance and control structures. An annex to the Dear CEO letter also provides examples of good practice and highlights where the PRA sees gaps between firms' intentions and its expectations.

In particular, metrics and quantification were identified as the most challenging aspect of assessing climate-related financial risks.

The PRA recognises that there are some areas where the science, data or tools are not yet sufficient to estimate the risks accurately. In these cases firms should ensure that identified risks are recognised through the use of reasonable proxies and assumptions.

The PRA will continue with its ongoing engagement on climate risks to discuss the implementation and progress of implementation plans with key individuals, in particular assigned senior management function holders.

Firms should also expect climate-related financial risk to be integrated within the PRA's full range of regular supervisory activities, including the 2021 BES exercise. The PRA said that it expects boards to receive periodic updates throughout a firm's embedding process.

Next Steps

An update on the Forum's forward-looking work and future outputs will be provided later in 2020.

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