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KLIMAAT

Stretching Analysis: is your firm's approach to climate scenario analysis in line with the proposed UK regulations?

An overview to the new "CP10/25 – Enhancing banks' and insurers' approaches to managing climate-related risks"

On the 30th April, the UK's Prudential Regulation Authority (PRA) launched "CP10/25[1]", its consultation paper on managing climate-related risks which will update the supervisory statement (SS3/19). The new draft supervisory statement (SS) now runs to 40 pages, replacing a far more modest eleven pages in SS3/19reflecting the evolving landscape since 2019. As an extensive consolidation of supervisory thinking, it provides everyone with a potential climate risk management benchmark for their current practices and efforts. Actuaries will be particularly interested in the expectations it sets for climate scenario analysis.

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CP10/25 is a consultation paper which the PRA issues to gather industry feedback before finalising rules or guidance. For the UK regime, rules are mandatory setting out the requirements. Supervisory statements (eg SS3/19) are not mandatory but set out the regulatory expectations of firms and frameworks to help judge if those expectations have been met[2]. Accordingly, the consultation paper's stated aim is to 'set out clear, straightforward and concise expectations about climate-related risk identification, management and governance outcomes that the PRA would like to see from firms'. It also wants to 'provide space for firms to take action and develop innovative solutions that are most suited to their business'. The paper comments that the proposals are often 'simply applying existing regulatory approaches to managing risks (for example, in relation to effective governance), but with greater clarity on how they apply to climate-related risks specifically'[3] and it also make several references to proportionality. In his launch speech, David Bailey stated "*the proposed expectations consolidate and clarify the feedback that the PRA has provided publicly on climate risk since SS3/19 was published. They will align our approach with the relevant international standards for insurers and banks in a way which is consistent with the PRA's objectives.*"[4]

The draft statement contains seven chapters covering governance, risk management, climate scenario analysis (CSA), data, disclosures, banking-specific issues and insurance-specific issues.

DIVING INTO CLIMATE SCENARIO ANALYSIS

Each chapter has interesting elements, but of particular interest to UK and European (all!) actuaries will be the selection, application and communications of climate scenario analysis.

David Bailey stated 'climate related risk management practices cannot rely on historic data in the same way as for traditional risks... This reinforces the importance of scenario analysis as a key tool for all firms, and... we therefore place greater emphasis on the rigorous use of scenario analysis.'

There are some notable parallels between the expectations outlined in the paper and the 2024 Institute and Faculty of Actuaries (IFoA) Climate Scenarios risk alert[5] especially on understanding and communicating the limitations of climate scenario analysis. The paper

also seems to take on the findings of the IFoA's Climate and Sustainability Scenarios Committee, which expressed concern that organisations and their executive boards might fall short of the understanding and competencies required for good climate risk governance[6].

The chapter on climate scenario analysis (CSA) divides into four sub-headings:

- **The role of CSA**: the PRA observes 'many firms lack adequate understanding of the climate-related risks they face, with little evidence that they appropriately account for those risks in their decision-making and risk management.' In response, it proposes firms 'appropriately document how their CSA fulfils their objectives and informs their decision-making'. Firms 'should be aware of the limitations and uncertainties associated with the CSA models ...and account for those when using the results'. Echoing the IFoA risk alert, the PRA comments 'current CSA models... do not capture the full range and scale of climate-related risks' thus their proposals seek 'to ensure firms interpret and use the results in full knowledge that they may be exposed to greater risks' than these models quantify.

- **Selecting scenarios and use cases**: this states that firms should 'select, match and tailor scenarios as relevant for their objectives and specific use cases' including 'relevant jurisdictional climate targets'. The paper highlights a wide range of use cases from business strategy and risk appetites to valuations, liquidity and solvency. It explicitly mentions own risk and solvency assessment (ORSA) with an expectation to document and demonstrate how CSA informs decision-making and 'support embedding... [the output into] firms' approaches to internal capital adequacy, own resources and solvency'.

- **Scenario analysis and calibration**: 'The PRA has observed that some firms lack adequate understanding of the scenarios they use'. It notes 'inadequate application of CSA results leads in some cases to poorly supported conclusions that climate-related risks are immaterial for the firm'.

- **Scenario governance, controls and review**: Based on their engagements, the PRA states 'some [firms] continue to rely on scenarios provided by external suppliers without appropriate adaptations and updates'. It proposes firms 'regularly review and update their scenarios in line with modelling and scientific advancements and the changing nature of risks to the firm'. Further, 'the board and management body would be expected to have an adequate understanding of the CSA, including of the limitations of the models and toolkits used and the main sources of uncertainty, to inform their interpretation and use of the results. Where appropriate, firms would be expected to conduct sensitivity analysis of their model choice and calibration.' There is also an explicit proposal for reverse stress testing 'to consider what type of climate scenario would result in the firm no longer being able to carry out its business activities'.

Within the CSA section of the drafted supervisory statement there are some more explicit details of these expectations:

- It explicitly references 'non-linearities and potential tipping points' as part of CSA limitations to be accounted for in the use of the results.
- It highlights the distinction in scenario use-cases between plausible 'central case' calibrations and 'severe but plausible tail risks' providing the following table of examples[7]:

CSA use case	Scenario time horizon	Frequency	Calibration
Business strategy	Medium to long-term, to capture impacts on the firm's business from longer term developments that may require action now	At least annually review whether the most recent long-term CSA still meets its objective, and consider updating in the case of a sudden change in external circumstances	Plausible 'central case' while recognising some climate-related impacts will materialise in all scenarios
Risk management	Typically short-term, but longer-term if relevant for firm's exposures	In line with the firm's risk management strategy	Should capture severe but plausible tail risks
Capital setting	In line with the firm's ICAAP[8]/ORSA		Should capture severe but plausible tail risks
Valuation	In line with relevant accounting standards		Reflecting a range of selected scenarios and in line with relevant accounting standards

The central role of scenarios is reflected by their 75 mentions in the consultation paper and 90 times in the statement. There are cross-references in almost all the other chapters:

- **Governance**: the 'PRA has observed that climate-related risk analysis provided to boards is often unclear and is generally insufficiently specific or targeted'. The paper proposes explicit expectations of Boards including reviewing the strategy impact from a range of climate scenarios and agreeing climate-specific risk appetite. Firms should also be able to demonstrate how 'any climate goals that it has either adopted itself or is required to meet in the jurisdictions (including the UK) [are integrated] within the firm's overall business strategy'. Suitable Board training should also be provided.

- **Risk identification and assessment**: scenarios aren't explicitly mentioned in this section, but risk identification goes to the heart of risk management with the PRA noting 'variance in the quality and depth' of climate risk identification with 'further work required by all firms.' The statement has extensive guidance on client, counterparty, investee, policyholder and operational risks with further comments on measurement, monitoring and reporting.

- **Data:** highlights reliance on externally supplied data and sets out expectations on oversight and governance.

- **Disclosures**: highlights the expectation of moving to International Sustainability Standards Board (ISSB) and the alignment of scenario analysis with 'the ISSB principle of disclosing information that enables users to understand the resilience of a firm's strategy and business model'

- **Insurance-specific issues**: 'the PRA has observed that insurers' ORSAs do not always assess the potential impact of climate change with sufficient depth or granularity'. In response, it proposes 'ORSAs should include climate scenarios when climate-related risks are material...[and] detail the investment and underwriting changes they would make in response to climate-related risks and what metrics and indicators they would monitor to inform those decisions and their timing'. Similarly, the PRA note that insurers' SCRs and regulatory balance sheet do not consistently reflect the impact of all climate-related risks.

CONCLUSION

Whilst the climate scenario analysis is a substantive element of the draft statement, there are other extensions to the original SS3/19 throughout the statement, particularly on governance and risk management. What is more, this is currently a consultation, and therefore we may also see further explanation and clarification ahead of formal adoption. For example, the statement is currently silent on biodiversity and nature-related risks. Nature-related risks have strong inter-connections and similar quantum of impact to climate risk and are currently being reviewed by the UK's Climate Financial Risk Forum. So we may see more guidance on those in due course.

Notwithstanding these potential future updates, for actuaries and climate risk professionals everywhere, this already provides an interesting consolidation of supervisory expectations on managing climate risk and thus a potential benchmark for current practices and efforts for everyone. ■

1 – https://www.bankofengland.co.uk/prudential-regulation/publication/2025/april/enhancing-banks-and-insurers-approaches-to-managing-climate-related-risks-consultation-paper

2 – https://www.prarulebook.co.uk/

3 – https://www.bankofengland.co.uk/prudential-regulation/publication/2025/april/enhancing-banks-and-insurers-approaches-to-managing-climate-related-risks-consultation-paper

4 – https://www.bankofengland.co.uk/speech/2025/april/david-bailey-speech-at-a-climate-financial-risk-forum

5 – https://actuaries.org.uk/media/ue4hdq3l/risk-alert-climate-change-scenario-analysis.pdf

6 – https://blog.actuaries.org.uk/findings-climate-and-sustainability-scenarios-committee/#findings

7 – https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2025/april/cp1025-appendix.pdf

8 – The Internal Capital Adequacy Assessment Process (ICAAP); https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2025/ss3115-february-2025-update.pdf