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Submission to the PRA Consultation CP10/25 — Enhancing banks' and insurers' approaches to managing climate-related risks — Update to SS3/19

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About this submission

This report consists of a submission by the Centre for Economic Transition Expertise (CETEx) made in response to the open consultation by the Bank of England CP10/25 — Enhancing banks' and insurers' approaches to managing climate-related risks — Update to SS3/19. See details of the consultation here: https://www.bankofengland.co.uk/prudential-regulation/publication/2025/april/enhancing-banks-and-insurers-approaches-to-managing-climate-related-risks-consultation-paper. This submission draws on research and insights from across the Centre for Economic Transition Expertise (CETEx) at the Grantham Research Institute on Climate Change and the Environment and was led by **Agnieszka Smoleńska**, with contributions from **Matthias Täger**, **Laudine Goumet**, **Elena Almeida**, **Hugh Miller** and **Ira Poensgen**. The response to the consultation was submitted on 29 July 2025.

The submission builds on the following CETEx publications: Smoleńska A, Feyertag J, Reitmeier L, Dikau S and van 't Klooster J (2024) *Submission to the BCBS consultation on a disclosure framework for climate-related financial risk*; Tamburrini F, Hiebert P and Smoleńska A (2025) *Exploring a macroprudential complement to transition planning*; Smoleńska A and Poensgen I (2025) *Integrating transition planning into prudential supervision*; Smoleńska A, Chan T, Poensgen I and Higham C (2025) *Banks and climate litigation risk: navigating the low-carbon transition*; Reitmeier L, Smoleńska A and Dikau S (2025) *Coordinating the net zero transition: a practical framework for policymakers*.

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Context

Over the last decade, the Bank of England's leadership in advancing a nuanced approach to climate change risk management has been a major driver of recognition among central banks globally that the physical and transition risks resulting from climate change are a source of material financial risks to banks and insurers (Carney, 2015; Bank of England, 2019). However, the UK financial sector has been slow to consistently adjust its practices. In this context, the Prudential Regulation Authority's (PRA) Consultation CP10/25 — *Enhancing banks' and insurers' approaches to managing climate-related risks* (SS3/19), provides timely further guidance on how banks' and insurers' climate change risk management should be improved with a view to ensuring safety and soundness and resilience over the course of the transition. This consultation response prepared by the Centre for Economic Transition Expertise (CETEx) offers several avenues to refine the proposed PRA approach, drawing on research across the LSE's Grantham Research Institute on Climate Change and the Environment.

State of climate change risk management in the UK banking sector

As the PRA recalls in the consultation overview (para. 1.5), the state of climate change-related risk management among UK banks is uneven. The UK financial sector continues to be heavily exposed to fossil fuel companies (FinanceMap, 2025). The Bank's own research suggests that, "even under an orderly transition scenario, less than 35% of transition risk impact is priced in" (Bank of England, 2024). In addition to persistent transition risk exposures, there is limited evidence of integration of climate change's physical risks in financial sector decision-making (CCC, 2025: 86). In fact, despite the increasing frequency of physical risk events triggered by climate change, financial market participants appear to have been deprioritising climate risk management in recent years, continuing to treat it largely as a medium- and long-term risk (Bank of England, 2025a). Such underestimation of short-term risk impact may be the result, not of capability gaps, but, in particular, of regime gaps, where the existing capital regime fails to adequately capture material risks to which banks are exposed (Bank of England, 2025b). Meanwhile, since 2019, significant progress has been made by supervisors globally in refining the approach to climate change risk management (BCBS, 2022; FSB, 2025a; NGFS, 2021). Further enhancement in the treatment of climate change risks in bank practices would strengthen the resilience of the financial sector and its ability to support growth and investment over the course of the transition.

Key recommendations

In this submission, we address the following key points in relation to supervision of banks' approaches to managing climate-related risks in particular:

- **A resilient financial sector can support the process of adjustment to the transition in a way that accelerates growth, competition and the net zero transition globally.** So far banks continue to underestimate the climate change-related risks and investment opportunities in the transition.
- **While a dedicated guidance on climate change risks supports the enhancement of banks' approaches, climate change factors are drivers of existing prudential risk categories (credit, market and operational risk).** Assessing how banks integrate climate change risk factors into their business models and risk management should be consistently integrated across supervisory review and evaluation processes.

- **Proportionality in integrating climate change factors in prudential regulation and supervision should not rely solely on banks' self-assessment of materiality of climate change factors.** Supervisors should likewise calibrate their approach depending on the risk profile of the supervised firm and be ready to question banks' assumptions, especially in cases of high concentrations of climate change risk exposures in sectoral or geographic terms.
- **Supervisory expectations are an important tool for prudential authorities to enhance the state of banks' climate-related risk management.** In addition to formal guidance, supervisors may use other soft tools such as collaborations with industry and academia. Credible supervisory guidance should be accompanied by enforcement actions.
- In relation to the PRA's proposals, drawing on existing Centre for Economic Transition Expertise (CETEx) research, the following suggestions are put forward:
    - **Scope:** The Supervisory Statement should explicitly address nature-related risks. These not only amplify climate risks but also pose distinct threats such as soil degradation, water and air pollution, and pollinator decline that may fall outside the scope of climate-only risk assessments. A joint climate change and nature-related risk approach will help ensure financial institutions fully understand, assess, and mitigate the breadth of environmental risks and avoid underestimating their exposure.
    - **Governance:** The PRA principles rightly elevate the importance of board ownership over the process of integration of climate change factors in business model and risk management at the strategic level. The proposals could be further reinforced to ensure adequate capacities at board level and across the organisation.

      Risk management: The Bank should provide further details on how risk identification (e.g. via climate scenario analysis) should inform risk mitigation by banks. In this regard, the Bank could consider bank transition planning as a risk management tool.
    - **Climate scenario analysis (CSA):** The Supervisory Statement should provide further guidance on the deployment and transparency related to CSA (e.g. requiring firms to document related decision-making, incorporate national climate goals, disclose which material risks are covered or not, use long-term time horizons). Banks should be required to clearly articulate how CSA is guiding their risk mitigation actions and integrated in their governance.
    - **Disclosures:** The PRA should consider introducing the Basel Committee on Banking Supervision's (BCBS) voluntary framework for the disclosure of climate-related financial risks to support global interoperability of physical and transition risk metrics in bank risk management.

Principles for supervising banks' approaches to managing climate change risks

In this section, we outline high-level principles that the Bank may consider in implementing the Supervisory Statement. While clarifying expectations as regards how firms should enhance their climate change risk management is a welcome step, however, compliance with the revised SS3/19 should be integrated in a consistent way across the supervisory review and evaluation process (SREP) and related procedures. Providing further clarity in this respect may support accelerated adjustment of practices by the financial sector. In addition, we propose how the implementation of the SS3/19 should be calibrated to achieve cross-policy coherence and leverage a broader academic and research ecosystem, with a view to supporting public policy objectives related to growth, competitiveness and advancing the net zero transition globally, in addition to the primary goal of safety and soundness of banks.

Role of supervisory expectations

Supervisory expectations are an important tool for prudential authorities to clarify their approach to review and evaluation of banks' governance and risk management practices (Bank of England, 2025c). They can support a dynamic interpretation of the regulatory framework that is focused on achieving policy objectives in changing circumstances. Even as the short-term impact of climate change is already materialising, the prevailing uncertainty related to the medium- and longer-term impacts as well as the insufficient progress with respect to climate change risk management, suggests that without clear guidance from supervisors, the robustness of banks' approaches will continue to lag behind. So far, the financial sector has been relying largely on untransparent methodologies and external rating providers to develop internal risk management procedures relating to climate change factors. If this is the way forward, banks have a clear incentive to downplay risk, and assume that given the systemic risk impacts of materialising climate change risks, public finances will provide a backstop. Furthermore, large financial institutions will gain a significant advantage over smaller, less well-resourced firms, undermining competition in the market. Further, an approach that is overly deferential to banks' internal models and methodologies blurs the division of responsibility between banks and supervisors with respect to the public policy objective of ensuring safety and soundness within the financial sector (Smoleńska and van 't Klooster, 2022).

Consistent integration of climate change in supervisory review and evaluation processes

The PRA should clarify how it intends to consistently integrate climate change considerations across supervisory review (see Chapter III, BCBS, 2022). As approaches to climate change risk management are developing, it is helpful to develop dedicated guidance to sensitise the financial sector to the specific challenges. However, such specific guidance should not suggest that the assessment of banks' approaches to climate change risk management is a new process running in parallel to existing supervisory reviews and evaluations. Rather, in the context of the bank sector specifically, climate change affects existing prudential and regulatory risk categories, including credit, market and operational risk, and how banks manage such risks should be assessed as part of Pillar 2. The challenge is to ensure that climate change is adequately integrated in banks' internal capital and

liquidity assessments, including internal ratings models. Insufficient integration of climate change factors in banks' assessments may lead to misallocation of capital and undercapitalisation.

As regards credit risk, physical and transition risks can induce a deterioration in borrowers' ability to repay their debts and a depreciation of assets used for collateral. They impact, therefore, on the probability of default (where they may put creditors under additional strain), and loss given default (where value of collateral may be affected, for example by floods or regulatory interventions regarding energy efficiency). Basel rules require banks to hold specific capital for the event of unexpected losses resulting from capital risk (under Pillar 1), in addition to Internal Capital Adequacy Assessment Process (ICAAP) Pillar 2 requirements. As regards market risk, prudential rules require banks to hold capital against market risk to which they are exposed as a result of stock market prices, interest rates, exchange rates, and commodity prices (Campiglio et al., 2023; de Bandt et al., 2024). In the context of climate change, market risk may materialise as sudden loss in the market value of assets, for example due to a sudden change in investors' perception of profitability of carbon-intensive assets, and can potentially lead to fire sales or 'stranded assets'. Physical risk factors such as droughts, floods and heat stress have already been shown to impact company valuations (de Bandt et al., 2024). As regards operational risk, in the context of climate change and environmental degradation, financial institutions and their operations can be affected through their direct exposure to physical risks (e.g. if a data centre is destroyed by a flood). Operational risk also includes legal risk related to climate change-related litigation, as described in Box 2 (Smoleńska, Chan, Poensgen and Higham, 2025). Recent analyses have shown that climate litigation is not currently adequately accounted for in financial risk assessments (Wetzer et al., 2024), even as evidence mounts to show that case filings and decisions negatively affect firm value for carbon majors (Sato et al., 2024). A forthcoming survey study of 811 equity investors and analysts indicates that investors regard climate litigation risk as a significant financial concern, on the basis of novel evidence directly measuring investors' beliefs about such risk and drawing attention to the multidimensional impacts of litigation that extend to broader market dynamics (Gostlow et al., unpublished manuscript). It appears from the PRA consultation that banks may be focusing on reputational risk while underestimating financial risk categories outlined above, which suggests that further guidance is necessary, especially as regards legal risk (para. 2.96).

The implementation of the guidelines should therefore go hand in hand with consistent integration of climate change in supervisory assessment processes. The PRA should also consider the role of industry peer reviews, which enable best practices to be identified and support innovation in climate change risk management. It is imperative that supervisors adopt a sufficiently clear stance as to the type of practices that they consider adequate means of climate change-related risk management, integrate such assessments across review and evaluation processes in a consistent manner, but also do not shy away from taking action where deficiencies in bank practices are identified. Meanwhile, the continued underestimation of climate change risks by the financial sector suggests that so far consistent integration of SS3/19 in supervisory processes has been lacking. Furthermore, the Supervisory Statement should clarify what supervisory powers the PRA would consider using in cases where the assessment of banks' approaches to managing climate-related risks identifies inadequacies (see para. 2.83). Such powers could include warning and supervisory notices as well as, in cases of significant inadequacies, additional Pillar 2 capital requirements. Credible supervisory guidance requires adequate resourcing and training within the Bank and the PRA's supervisory teams.

Proportionality

With the Supervisory Statement to be applicable to a wide set of entities, ensuring proportionality of rule application is a key consideration. Proportionality as a principle serves to ensure that the aims of the policy intervention are achieved with the least burden on entities. Proportionality may be achieved by requiring different levels of sophistication from smaller and large banks, reduced frequency of reporting or less granular requirements. The PRA's approach, outlined in paras. 1.28-1.32, requires firms to develop a two-step approach involving use of scenario analysis for risk identification followed by a tailored response, and is a mechanism that allows for variance in banks' approaches depending on the magnitude of material risk exposures. In assessing banks' compliance with the Supervisory Statement, the Bank should mirror this approach. Supervisors should be ready to test banks'

assessments with regard to materiality assessments and scenario choices and likewise calibrate the intensity of supervisory review processes to the specific climate change-related risk profile of the institution, with more proactive questioning of approaches of banks, especially in cases where high concentrations of climate change-related risk related to sectoral or geographical exposures are identified. The Bank may provide further guidance on how such proportionality will be reflected in supervision (see para. 5.8A of the Bank's Supervisory Statement SS31/15 on ICAAP and SREP, Bank of England, 2025c).

Consistency and cross-policy coordination

The success of the green transition from a financial stability perspective hinges on the economic actors' ability to transform their productive structures, while minimising financial disturbances and instability. In this regard, it is relevant that the UK Chancellor's 2024 remit letters mention explicitly net zero transition in relation to micro-prudential supervision, financial stability and monetary policy functions of the Bank. Without prejudice to the division of tasks across the respective functions, the Bank should therefore consider further mechanisms for policy coordination, in particular as regards ensuring policy consistency (Reitmeier et al., 2025). Efficient coordination between micro- and macroprudential policy functions supports managing the transition in a way that is least disruptive and costly to the public finances over the medium and long term (Bank of England, 2024; Smoleńska, Tamburrini and Hiebert, 2025). For example, the Bank may consider how the insights related to management of climate change risks by individual firms, given the systemic dimension of this risk, may inform calibration of macroprudential policy (See Box 1).

Box 1. Quantitative metrics and qualitative information in bank transition plans

Credible transition planning relies on clear metrics and qualitative information that should underpin governance adjustment and implementation. As showcased in a recent Organisation for Economic Co-operation and Development report, existing net zero frameworks followed by banks fall short in this regard (OECD, 2023a). In particular, they often lack quantifiable metrics (relying on qualitative information instead), have methodological gaps regarding calculation, use inconsistent terminology, do not have provisions for measuring progress, and feature gaps in key areas such as the use of carbon offsets. Nevertheless, as highlighted by the Financial Stability Board (FSB), advances in machine learning and supervisory technologies offer better prospects for supervisors to integrate qualitative information into their assessments (FSB, 2025b).

Increasingly concrete climate change risk metrics are being identified, and dedicated disclosure requirements introduced (EBA, 2022; BCBS, 2023). Bank transition planning information can provide information that is relevant to financial stability through different channels, such as firms' strategy-setting and climate-related risk management, and forward-looking information supporting investment decisions and indicators for macro-monitoring of transition risks, both in the financial system and the real economy. Examples of such quantitative information may include:

- Current and expected exposure to climate risks under different scenarios
- Current and expected exposure to assets at risk of being stranded in the short, medium or long term
- Current and expected absolute value/share of revenues derived from emissions-intensive sectors
- Amount and share of income related to business with counterparties operating in emissions-intensive sectors
- Amount and share of counterparties operating in emissions-intensive sectors, with credible transition plans in place
- Concentrated exposures in sectors or geographies vulnerable to climate risks
- Planned real economy CapEx investments in climate mitigation and adaptation
- Current and expected alignment of the portfolio (total or key segments) to climate scenarios
- Percentage of total counterparties with whom institutions actively engage on transition-related challenges

Balancing public policy goals in prudential supervision

The primary goal of prudential supervision is ensuring safety and soundness of financial institutions. This goal is pursed through a combination of mandatory requirements and supervisory discretion. Such discretion should be interpreted through the lens of the Bank of England's secondary objectives (competition, competitiveness and growth) and guidance provided in the Chancellor's remit letters (e.g. relating to promotion of sustainable and transition finance). In this context, it is important to recall that an appropriate balance between risk-taking and stability is needed to support innovation and change in transition. Such balance is achieved by simultaneous implementation of different relevant policies: micro- and macroprudential regulation as well as government policy related to net zero transition. A resilient financial system can support the process of adjustment and transition along Paris alignment pathways.

So far, the prudential framework, with its reliance on backward-looking models using historical data to predict future crises, has failed to be appropriately risk-sensitive over the medium term and may as a result invertedly favour investments in activities that are misaligned with climate change mitigation goals or those that underinvest in adaptation, risking future bailouts (Espagne et al., 2023; Gözlügöl, 2025). This may result in regulatory disincentives in transition investments that are not justified from a prudential perspective. Meanwhile, in the light of increasing geopolitical and fragmentation risks, specific types of investments in the transition, including climate change mitigation and adaptation, could serve as risk mitigants (Noss et al., 2024). Calibrating the supervisory approaches in a way that supports risk sensitiveness and robust forward-looking approaches to managing climate change risks will support achieving the UK's growth potential and net zero transition globally in a credible way (HM Treasury, 2024).

Unintended impacts on emerging markets

In implementing the revised Supervisory Statement approach, it is advisable that the Bank consider the global financial stability dimension, in particular in relation to UK firms' exposures in emerging markets to ensure a risk-sensitive approach to physical and transition factors in banks' risk management approaches across geographies. While not falling directly within the scope of the Supervisory Statement, the Chancellor's remit letters encourage the Bank to consider a global perspective to the net zero transition, with the UK playing a leading role in this process as a global financial centre.

Firms with global operations or counterparties in emerging markets and developing economies (EMDEs) face heightened physical risks due to greater climate vulnerability, and potentially significant transition risks arising from uneven policy development, regulatory uncertainty, and limited access to green finance in those jurisdictions. Additionally, data availability and disclosure practices in emerging markets often lag behind those in advanced economies, which can amplify model uncertainty and complicate scenario analysis. However, Basel III frameworks may further overestimate the riskiness of exposures in emerging markets in a way that is not risk-sensitive, inadvertently dampening flows of capital to climate finance in EMDEs. Meanwhile prudential regime gaps in advanced economies may lead to underestimation of climate change risks in home jurisdictions. Combination of these factors may simultaneously increase costs of climate change adaptation in emerging markets and increase financial instability risks in advanced economies. Dedicated discussions on the impacts of climate change factors within supervisory colleges and further analytical work on Basel III implementation could support a proportionate and risk-sensitive implementation of the Supervisory Statement in this respect.

Research and academic collaboration

In addition to the Supervisory Statement, further guidance to firms can take multiple forms and draw on collaborations across industry and academia. Collaborative approaches to developing methodological capacities with industry are already in place, as is the case with the Climate Financial Risk Forum (CFRF). Developing further collaboration with academia can support both the supervisors and the supervised entities in developing adequate responses to climate change risk management and address current gaps in data, modelling, and methodologies for assessing climate-related risks. Academic partnerships can provide independent, evidence-based insights into evolving climate science, socioeconomic transition pathways, and risk quantification techniques, helping to reduce reliance on assumptions and proxies.

Such collaboration with academia should also enable the development of standardised, open-access tools and datasets, supporting proportionality for smaller firms and improving the overall robustness of scenario analysis and stress testing. By leveraging academic expertise, the PRA can foster innovation by ensuring supervisory expectations remain grounded in the latest scientific and economic understanding.

Response to the PRA's proposals

Given the progress made in recent years as regards climate change risk management methodologies and global supervisory approaches to effective supervision of such risks, the PRA's intention to revise the 2019 Supervisory Statement is a very timely one. In this section we propose several refinements to the approach, in particular as regards the scope of the revised SS3/19, bank governance, transition planning, climate scenario analysis and the disclosure framework.

Scope: nature–climate change nexus and compounding risks

The proposal acknowledges and identifies climate risks as material for financial institutions. However, this explicitly ignores broader environmental degradation (e.g. water pollution, soil degradation, pollination decline) as risks. Similar to climate risks, non-climate environmental risks (or nature-related risks) are material for the financial system, and can be categorised into physical and transition risks (NGFS, 2024a; OECD, 2023b). These risks are already acknowledged as material by financial supervisors internationally, in advanced economies as well as emerging markets (FSB, 2024). For example, Banco Central do Brasil (BCB) since 2017 and the Monetary Authority of Singapore (MAS) since 2020 have been actively integrating nature-related risks into their supervisory framework, through targeted supervisory requirements and data collection (FSB, 2024). Moreover, financial institutions, including institutions based in the UK such as NatWest, Lloyds Bank, and Aviva were in 2024 already including nature-related risks in their strategies, as disclosed in the firms' sustainability reports. It is imperative for financial institutions to comprehensively understand and assess environmental risks in a broader context.

Given growing evidence of the materiality of nature-related risks (TNFD, 2025; Almeida, Colesanti Senni and Rastoka, 2025; Ranger et al., 2023; Johnson et al., 2021), including in the UK (Avery et al., 2024), it is essential that standard setters and supervisors adequately consider these risks to ensure that financial institutions build the necessary resilience to identify and manage them effectively. While there are some similarities between the transmission of climate and nature risks to the economy and financial system, nature-related risks tend to be chronic and manifest locally, with impacts felt at a specific location or region (Almeida, Colesanti Senni and Rastoka, 2025). As supervisors worldwide, such as the European Banking Authority and De Nederlandsche Bank, begin to integrate environmental risks into their frameworks, the UK should also enhance its efforts to prevent the potential buildup of green systemic risks or 'green swans'.

Climate change and nature degradation are not isolated threats; they are deeply interconnected crises that exacerbate each other and pose significant threats to economic stability and financial security (NGFS, 2024a). These climate and nature-related threats can interact, amplify or succeed one another, thereby intensifying stress on businesses and transmitting these stresses to the financial system. Recognising the climate–nature nexus and adopting a systemic approach to the environmental crisis in decision-making is no longer optional, and governments, including the UK Government, are beginning to acknowledge this (UK Government, 2025). Nature-related risks and objectives featured in HM Treasury's latest remit letters to the Bank of England. In HM Treasury's remit letter to the Financial Policy Committee, the Committee was asked to have regard to the materiality of nature-related financial risks for its primary objective (HM Treasury, 2024; Almeida, Dikau and Waaifoort, 2025). Considering climate and nature separately or sequentially in monetary, financial, economic and fiscal policymaking will leave blind spots in risk assessments, reduce the effectiveness of policy interventions, overlook opportunities for co-benefits and delay building resilience into our economic systems.

Governance

Governance arrangements and in particular board ownership over banks' climate change risk-related strategies is critical for the credible implementation of the latter (esp. para. 2.9). The proposals to extend the responsibility of the firms' boards and ensure they have appropriate training and access to climate-related risk analysis are therefore highly welcome. To further align the Supervisory Statement with international best practice and standards (especially BCBS, 2022), the introduction of several further expectations should be considered.

First, the PRA should fully implement Principle 4 of the BCBS Principles for effective management and supervision of climate-related financial risks in relation to effective controls (BCBS, 2022). Para. 2.21 fails to provide sufficient detail as regards the expectations in relation to how banks should be integrating climate change risk factors within the scope of the three lines of defence and, in particular, in the case of banks, client risk assessments, the risk function (including risk committees) and internal audits. These requirements should be further elaborated in the context of bank-specific guidance (paras. 2.90-2.92).

Second, beyond training (para. 2.7), the PRA should also consider the mainstreaming of the requirements across other relevant supervisory guidance, such as rules related to the Senior Managers Regime. Without considerations of whether senior bank management possesses adequate understanding of the financial implications of climate change and environmental degradation, the delivery of the expectations articulated in the Supervisory Statement may not be possible. Consistent integration of capacity building across the organisation should likewise include workshops and external collaboration with expert organisations (para. 16, BCBS, 2022). Clarity of the PRA's expectations in relation to climate expertise among board members is a precondition to enable delivery of strategy adequately reflecting related risks (e.g. paras. 2.11 and 2.12). In this respect, the PRA might also consider referencing best practice developed within expert organisations (e.g. Climate Governance-related indicators under the Net Zero Banking Assessment Framework, developed by the Transition Pathway Initiative, 2023).

Third, to align the supervisory expectations with the BCBS standard, the PRA should consider introducing further proposals to align banks' internal incentive structures with climate change risk management (Principle 1, BCBS, 2022).

Risk management

The PRA's efforts to embed materiality within its updated supervisory expectations are a positive and pragmatic step towards ensuring climate-related risk management is both risk-sensitive and achievable (para. 2.84). However, the approach proposed would benefit from further clarity and practical guidance to support consistent application across firms (e.g. case studies or industry peer reviews). Specifically, firms would benefit from more illustrative examples of how materiality should be assessed in complex portfolios and under different time horizons, particularly where forward-looking risk drivers are highly uncertain (see Box 1 for transition risk related metrics). In addition, providing case studies or thematic feedback on best practice would further strengthen the approach, helping firms align supervisory expectations with their own governance and risk appetite frameworks. To the extent that the PRA's approach relies on this step in the risk management process, ensuring transparency and stakeholder engagement in the materiality assessment is paramount (see further below on disclosures).

The Bank should provide further guidance as regards approaches to mitigating climate change risks, as currently the Supervisory Statement focuses largely on identification and assessment. While certainly the latter constitute an important first step, it is through guidance on mitigation actions in particular that the Bank could further support the alignment of banks' risk management approaches with the goal of achieving safety and soundness while supporting growth-enhancing investment in the transition as well as the UK's role as a leading sustainable finance centre.

Further scaling up the capacity of banks to identify climate change risks, for example through CSA, is an important step in the right direction. However, the PRA should provide further guidance on appropriate management of such identified material risks, in addition to client risks assessments (para. 2.90) and credit risk frameworks (para. 2.92), in particular as regards the "non-exhaustive list of mitigants" (para. 2.91). CSA is an important tool for measuring and assessing climate change risks, but not one that — in isolation — serves as a management tool (para. 2.94). The guidance to banks should better connect CSA outcomes to governance and risk management proposals. For example, with respect to the setting of the risk appetite framework, it is important that the impacts of climate change factors on regulatory capital be consistently considered (see para. 2.17). Furthermore, with respect to capital and liquidity, the PRA's proposals related to integrating the outcome of ICAAP assessments in banks' decision-making, should be further explicitly aligned with BCBS guidance (Principle 5, BCBS, 2022). Finally, consistent integration of transition planning approaches in bank risk management can support both the identification and the mitigation part of risk management. Without such a balanced approach to climate change risk, the safety and soundness of the financial institutions as well as their resilience is not assured.

Prudential use transition planning

Current prudential approaches typically operate on short-term horizons of three to five years, which are insufficient for capturing the nature of climate-related risks, in particular those related to the transition (though see development of the Network for Greening the Financial System's [NGFS] short-term scenarios, including with respect to physical risks, NGFS, 2025). These risks often materialise over much longer timeframes, well beyond standard business planning cycles. Without clear regulatory expectations on the consideration of longer horizons, banks may lack sufficient incentives to incorporate the results of materiality assessments or climate scenario analyses into their risk management and capital planning processes. Extending the time horizon for prudential purposes is also consistent with the increasing regulatory use of transition plans as tools to address the challenges posed by data limitations, short-term perspectives, and backward-looking methodologies (Dikau et al., 2024). We therefore recommend that the PRA provide clarity on how transition planning can support banks in identifying, mitigating and managing transition risks, including its role in capital adequacy assessment (NGFS, 2024b; Smoleńska and Poensgen, 2025).

The proposed Supervisory Statement rightly acknowledges that many banks — whether by their own initiative or under mandatory frameworks — are setting net zero targets and articulating transition strategies. The requirement for boards to ensure alignment between these external commitments and internal organisational changes (paras. 2.13–2.15) is a welcome step, as the robustness of transition planning is closely linked to banks' exposure to climate-related litigation risk (Clarke and Clay, 2025). However, transition planning should be understood not merely as a disclosure exercise but as a prudential tool, as it directly affects a bank's risk profile. A high-quality transition plan, grounded in a forward-looking assessment of the bank's climate exposures, is essential for resilience. Such plans enable the integration of climate considerations into financing decisions, client engagement, and portfolio management. Conversely, the absence of credible plans may indicate weaknesses in the identification and mitigation of physical and transition risks.

Transition planning also has clear relevance for existing prudential standards. Under Pillar 1, banks could explore ways to integrate climate risk factors into internal risk measurement and modelling, including potential impacts on probability of default and loss given default (Auzepy and Bannier, 2025). Under Pillar 2, transition planning should inform ICAAP by capturing additional sources of material risk, while allowing supervisors to assess the adequacy of banks' approaches in light of financial stability considerations (BCBS, 2022). We therefore encourage the PRA to provide further guidance on how it expects transition strategies to be integrated into governance frameworks, implementation plans, engagement strategies, and the setting of metrics and targets. These elements should ensure that transition planning aligns with a bank's stated risk appetite and supports adjustments to business models as risks evolve over time. Importantly, such planning should be dynamic and regularly updated to reflect changes in external conditions, including policy developments and market adjustments.

Finally, we urge the PRA to consider whether banks adequately account for the interaction and trade-offs between physical and transition risks in their forward-looking risk management frameworks. The speed and scale of today's economic transition will largely determine the severity of both physical and transition risks in the future. This means that the climate-related impacts of a bank's activities are relevant to prudential supervision even where immediate, short-term risks at the entity level appear limited. Incorporating these forward-looking considerations will help ensure that banks remain resilient in the face of material climate-related financial risks over the medium and long term.

Climate scenario analysis (CSA)

The guidance provided on climate-related scenario analysis (CSA) specifies and usefully explains key aspects of how scenario analysis can play a crucial role in understanding and managing climate-related risks. In particular, provisions in para. 2.40 asking firms to document how and whether CSA is being taken into account for decision-making will allow the PRA to gauge the degree to which insights from CSA are in fact being absorbed across a supervised entity. Guidance in para. 2.45 on the inclusion of relevant national climate goals into scenario analysis design is an equally important specification which will enhance the value of CSA for risk management purposes. Lastly, suggesting a reverse stress-testing scenario design to augment other more off-the-shelf scenario designs constitutes a welcome specification regarding the ways in which CSA should be made specific to the characteristics of the firm in question.

Some additional clarifications might be useful to further enhance the value of the guidelines to overall increase the capacity of the UK financial sector to manage climate-related risks. First, currently para. 2.40 suggests that all material risks should be considered in a CSA. While this certainly should be the ambition, current capacity constraints mean that it is unlikely that all material risks for a specific firm are covered in a CSA (see e.g. FSB and NGFS, 2022; NGFS, 2024c). Thus, the current formulation of the guidelines might create perverse incentives for firms to claim that all risks covered in their CSA are material rather than assessing the materiality of a wide range of risks first, to then gradually cover them in their CSA. Research across various academic disciplines has shown that evaluative tools and metrics at hand — for example, currently available climate scenarios — can easily become the focus of attention thus distracting from the phenomenon actually to be evaluated — that is, climate risk to a specific firm (see e.g. Choi et al., 2012; Muller, 2018). More specific to finance, metrics and models are known to be adopted even if they prove inaccurate, for example where they are useful for communication purposes or regulatory compliance (MacKenzie and Spears, 2014; Millo and MacKenzie, 2009). Hence, we suggest asking firms to be transparent about which material risks are and are not covered in their CSA rather than creating perverse incentives for firms to neglect risks not covered in their CSA which might, however, be material.

Second, in para. 2.46 the guidelines helpfully suggest matching the time horizons of scenarios to use cases. While thus making CSA more easily useable by firms, it bears the danger of unduly limiting the maximum time horizons considered. Given the possibility of an exclusive focus on shorter time horizons to create a 'tragedy of the horizons' and hence climate Minsky moments, PRA guidelines should make explicit reference to the need for exploring trajectories of scenarios used up to the year 2100. Especially, scenarios utilised for the purpose of public disclosures, that is, for the purpose of communicating to the wider market, should ensure that scenario designs are linked to temperature outcomes in the year 2100 as this is a metric most intuitively understood by the general public due to its use and socialisation by the Intergovernmental Panel on Climate Change (IPCC).

The guidelines could also be more specific with regard to the attention given to tail risks, which are — rightfully — foregrounded at several moments during the text. First, policy-related tail risks might not be covered by scenarios exclusively focused on national climate goals, that is, Nationally Determined Contributions (NDCs). In fact, most current NDC specifications are not sufficient to reach the global temperature goals outlined in the Paris Agreement (see e.g. UNFCCC Secretariat, 2024). Thus, unless the PRA takes the position of considering the Paris Agreement goals as out of reach, a Paris-aligned scenario should be part of any firm's scenarios suite to ensure transition tail risks are sufficiently considered. Second, the guidelines could further specify how technology-related tail risks could be part of CSA. Most importantly, the PRA should suggest to firms to consider 'no-magic-bullet'

scenarios, that is, scenarios relying on unprecedented scaling of experimental technologies to curb greenhouse gas emissions. Since such scenarios do already exist (see e.g. the One Earth Climate Model scenarios specified in Teske, 2019), this does not constitute an inappropriately onerous requirement for firms. Third, regarding physical tail risk, the recommended inclusion of a 4°C scenario constitutes a helpful clarification. In addition, however, in order to cover tail risks more comprehensively, firms should consider plausible scenarios in which the breaching of tipping points and positive feedback loops significantly limits humanity's ability to effectively control atmospheric greenhouse gas concentration, thus creating irreversible climate change, exceeding the risks in a more static 4°C scenario.

Lastly, the guidelines importantly highlight the need for firms to familiarise themselves with and make transparent assumptions and limitations underpinning scenario quantifications. The guidelines could be more specific in this regard and emphasise the relevance of the narrative part of a CSA, akin to storyline approaches to scenario analysis (see e.g. Fiedler et al., 2024). Suggesting to firms to increase the level of detail in the scenario narratives could be a crucial tool to cultivate the understanding and transparency of limitations of, for example, specific models. Explaining in a narrative style the nature and sequence of transition policy shocks and technology shocks, for instance, can reveal homogeneities of how transition pathways are anticipated across scenarios thus bringing to attention potentially counterproductive standardisation and 'group think' in the CSA space. Furthermore, a higher degree of sophistication in the narrative part of a CSA could facilitate a better translation and usability of scenario results within a supervised entity as well as enhancing usability of CSA disclosures to users of financial statements. This could help in overcoming the current issue of CSA results rarely being considered in investment decision-making. As already outlined above, the results of CSA should inform the risk management and governance proposals outlined in the consultation.

Disclosures

Following the publication of the BCBS framework for the voluntary disclosure of climate-related financial risks (BCBS, 2025; Smoleńska et al., 2024), the PRA should implement the standard. While the PRA is rightly concerned with the risk of overburdening the sector with disclosure requirements, given the existence of such requirements in other large jurisdictions, absence of guidance in this respect will impede global comparability and cross-border financial stability assessments (FSB, 2025b). In fact, many UK banks would already be partly reporting their environmental, social and governance (ESG) risk exposure under the EU regime (European Commission, 2022; EBA, 2025). Not requiring dedicated Pillar 3 disclosures may signal to the banking sector that the climate change-related risk metrics contained therein are of limited prudential and regulatory capital relevance.

In this respect, the Bank may consider the broader use case of risk-based disclosures, where they support a quantitative approach to climate change risk management and frontload development of solutions to addressing data gaps. Furthermore, where previously supervisors did not actively engage with such bank disclosures, being privy to much more detailed confidential reporting, risk-based disclosures related to banks' climate change risk management would further support supervisors' ability to assess the banks' reputational risk exposures. The supervisory use case for requesting Pillar 3 disclosures is particularly strong in the absence of targeted amendments to the supervisory reporting regime to integrate climate change risk factors.

Finally, the absence of clear and consistent guidance with respect to Pillar 3 disclosures may lead to an outcome where banks may not adopt coherent practices across functions and geographies. For example, in the context of legal risk specifically, Smoleńska, Chan, Poensgen and Higham (2025) find that large EU banks exhibit different understandings of the impact of climate change litigation risks depending on whether they are communicating this as part of the sustainability reporting or prudential (Pillar 3) reporting (see Box 2). For example, while some banks see legal risk as a driver of transition risk, others see it as an outcome of the latter. Likewise, banks may emphasise reputational risks related to climate change litigation, while underestimating the operational (legal risk) aspects.

Box 2. Climate litigation: a growing challenge for banks

Banks are facing growing risks associated with climate-related litigation, both lawsuits directly against the institutions and legal challenges impacting their clients and counterparties. Recent analysis by Smoleńska, Chan, Poensgen and Higham (2025) of bank disclosures reveals significant variations in how banks identify, assess and mitigate this emerging threat. In particular, bank practices reveal:

- Heterogeneity of approaches: Many banks focus on regulatory compliance and greenwashing but give less attention to litigation stemming from physical climate risks, transition mismanagement or human rights concerns. There are also inconsistencies in how banks link climate litigation to traditional financial risk categories, such as credit, market and operational risk. This can lead to inadequate capital allocation and risk management practices.
- Over-reliance on disclaimers: Banks rely heavily on waivers and disclaimers, particularly through forward-looking statements as a way of mitigating their risks, which suggests a lack of confidence in their own ability to accurately assess and manage climate-related risks.
- Underestimation of physical risk: Banks often overlook the potential for litigation arising from physical climate risks, such as 'failure to adapt' cases, for example those related to residential mortgages or damages to collateral.

Given the revealed shortcomings in risk management, clearer supervisory guidance is needed. Banks should integrate climate litigation considerations into their internal transition planning processes, develop robust scenario analysis and engagement strategies to address these evolving risks, and consider the impact of litigation on both the bank and its clients.

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