



CLIMATE FINANCIAL RISK FORUM UPDATE – JANUARY 2023

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BACKGROUND AND INTRODUCTION

In March 2019 the PRA and FCA jointly established the **Climate Financial Risk Forum (CFRF)** to address the challenges and opportunities arising from climate change and society's response to it. The CFRF has focused on the climate challenge through a financial risk lens, in line with the PRA's objectives to promote safety and soundness and FCA's remit to ensure sound, stable and resilient markets and financial systems.

The CFRF brought together senior representatives from across the financial sector to build capacity and share best practice across industry and financial regulators to advance the sector's responses to the financial risks from climate change. The CFRF also aims to develop practical tools and approaches to address climate-related financial risks.

In June 2020, Session 1 of the CFRF published the **CFRF Guide** and held a launch webinar which can be **viewed online**. The guidance document aimed to help firms understand the risks and opportunities that arise from climate change, and support firms as they adapt their risk, strategy, and decision-making processes. The guide was based on what was then considered good practice and has continued to evolve since.

In October 2021, the CFRF published the outputs from its Session 2 programme, and a summary prepared by the AFB can be read **here**.

The first meeting of the CFRF's third Session was held on 27 April 2022, and a summary prepared by the AFB can be read **here**. The outputs of the third Session were published on 13 December 2022 and can be read below.

CLIMATE SCENARIO ANALYSIS TOOL

During Session 2 of the CFRF, the Scenario Analysis Working Group began developing an **online climate scenario analysis narrative tool** to support smaller firms. On 23 June 2022, the CFRF published a beta version of the tool.

The CFRF Scenario Analysis Working Group is collecting feedback from users on this version of the tool and will update the tool to enhance content and reflect the latest NGFS scenarios in Q1 2023.

The tool generates a summary narrative description of climate-related risks and opportunities for the firm based on a set of pre-selected inputs (e.g. business activities models, products, risks of the firm). The narratives draw on data from scenarios developed by the Central Banks and Supervisors Network for Greening the Financial System (NGFS) as at June 2021.



CFRF ROUNDTABLE DISCUSSION: IMPLICATIONS OF THE CURRENT GEOPOLITICAL AND ECONOMIC ENVIRONMENT

On 29th July 2022, the CFRF convened a roundtable discussion to consider the implications of the current geopolitical and economic environment, on the transition to net zero carbon emissions and the response of the finance industry. The discussion was structured around two key topics:

- i. Implications of the current geopolitical and economic environment on the transition to net zero carbon emissions; and
- ii. How can the financial services industry respond to these challenges?

SESSION 3 GUIDES – DECEMBER 2022

TRANSITION TO NET ZERO WORKING GROUP

- **Mobilising Investment into Climate Solutions: Phase 1 Report**

This report provides high-level recommendations for financial institutions to consider with respect to mobilising investment into climate solutions, covering five broad themes:

- i. Considering financing across the full project lifecycle,
- ii. Exploring innovative financing instruments,
- iii. Engaging with recipients of finance,
- iv. Leveraging expertise to influence policy, and
- v. Sharing best practice.

- **Disclosures: Managing Legal Risks**

In 2021 the Climate Financial Risk Forum published **Disclosures – Managing Legal Risks** which formed part of a suite of broader guidance for financial institutions focused on climate disclosure, and included an annex setting out in summary the different TCFD-aligned disclosure regimes under development in the UK at that time.

This paper provides an update of the 2021 annex to reflect developments in the context of a fast-moving and evolving climate transition landscape. A separate paper will be published in 2023 focusing on legal considerations relevant to transition plans. The items covered in the paper are informed by legal professionals in the CFRF, as well as members from financial institutions. This work will be coordinated with that of the UK's Transition Plan Taskforce.

- **A Carbon Budget Primer for Financial Institutions**

Climate scientists have assessed the amount of further greenhouse gases that are permissible to be released into the atmosphere while limiting the environmental consequences. This amount is defined as the remaining “carbon budget”.

This paper is split into two sections:



- i. **The Science of Net Zero** – provides an overview of climate science and global warming and how that relates to carbon cycle and carbon budget.
- ii. **Carbon Budget, from Science to Practices** – explains how the carbon budget, which is global in nature, can be allocated to individual nations or industrial sectors to enable practical actions. Such allocations help design incentive mechanisms to decarbonise the economy and also set benchmarks for financial institutions to effectively measure and manage their own transition plan and climate strategy.

SCENARIO ANALYSIS WORKING GROUP

- **Scenario Analysis Guide for Banks**

The guide is structured in four parts:

- i. An evaluation of the benefits and challenges of working with a range of different publicly available scenario families. It sets out a framework for selecting the appropriate time horizon for scenario analysis, identifies principles that banks could have in mind as they select the most relevant and appropriate scenarios; including whether the characteristics of the scenario in question are compatible with the objectives of the exercise, sectoral and geographical coverage, and the granularity and scope of scenario variables.
- ii. An outline of how banks can use sensitivity analysis for key variables to add credibility to scenario analysis and, in some cases, produce more decision-useful information to management.
- iii. The key elements to consider when managing physical risks and assessing client adaptation plans. This section aims to facilitate improved understanding of the transmission channels through which physical risks might materialise for banks' wholesale and retail counterparties; it provides examples of physical risk adaption strategies that clients may choose to adopt, and gives an overview of relevant data fields that banks may choose to collect to understand better their client's adaptation readiness.
- iv. How to effectively incorporate the outputs from scenario analysis in banks' decision-making processes. The section provides a non-exhaustive list of potential use-cases for scenario analysis across a bank's business and risk management activities and product offerings and provides high level guidance on how climate scenario analysis might inform those processes.

- **Scenario Analysis in Financial Firms**

This chapter presents results of a deep dive on the maturity of fast-evolving climate scenario analysis practices in financial firms. It gives firms a tool for measuring the maturity of their own approaches relative to their peers.

The analysis presented is based on the results from **GARP's Fourth Climate Risk Management Survey** undertaken in Q2 2022.



- **Physical Risk Underwriting Guide**

This guide sets out to consolidate the reference material for the modelling of physical climate-related risks, together with an outline syllabus of the key questions that insurers should ask when assessing physical risks over a longer time horizon.

- **Climate Litigation Risk Chapter**

This chapter provides a list of cases that can provide insights for underwriters, particularly those cases yet to reach a conclusion – offering a form of ‘watchlist’ to help track these risks going forward. We also provide a series of recommendations to help underwriters to translate these words into actions and bring to life the concept of climate-aligned underwriting.

DISCLOSURE, DATA AND METRICS

- **Industry Frameworks and Metrics in Relation to Green and Transition Finance**

This paper contains three sections:

- i. Sets out observations around standards observed in the market;
- ii. Sets out the risks, uncertainties and challenges observed; and
- iii. Sets out recommendations for next steps.

Association of Foreign Banks

January 2023

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