Factsheet—Financial Climate Risk Regulation The United Kingdom

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PERSPECTIVE

The Bank of England has been on the forefront of acknowledging climate change as a material financial risk since before it was commonly discussed in the financial sector. Its Governor Mark Carney coined the term the "tragedy of the horizon" in 2015 referring to the economic risks of climate change. Since then, the Bank has become known for emphasizing climate change as an urgent threat to financial stability. It propels this conversation by framing issues and convening stakeholders around the challenges and uncertainties of climate risk. The Bank of England's views on climate risk provide an indication of how the broader financial sector will likely frame this issue. With the integration of climate change into its insurance stress tests, the Prudential Regulatory Authority (PRA) has shown that the Bank's declarations are starting to influence regulatory requirements. Paying close attention to developing perspectives at the Bank will help prepare financial actors for future regulatory changes to come.

STANCE

The United Kingdom (UK) government has been less consistently focused on climate change than its central bank, but the Bank has been given autonomy to pursue its climate agenda. In April 2019, Mark Carney announced that banks and insurers will be "expected to embed fully the consideration of climate risks into governance frameworks, including at board level," during a speech at a conference on sustainable finance hosted by the European Commission in Brussels. This was followed by a supervisory statement outlining these expectations.

The Bank of England is a founding member of the central banks and supervisors Network for Greening the Financial System, focused on propelling the transition to a low-carbon and sustainable economy.

Sarah Breeden, the Bank's Executive Director, laid out the Bank of England's views on the challenges brought about by climate change during a conference on the macroeconomic risks of climate change held in January 2019. Breeden outlined three reasons why climate risk is different than other macroeconomic risks regulators have dealt with in the past. First, climate risks are far reaching in their breadth and scope, affecting all players across sectors and geographies. Second, while the costs and risks are imminently foreseeable, the size of future costs are determined by actions taken today. Third, unlike other risks analyzed by traditional economic and financial models, climate impacts will be correlated and non-linear. The Bank of England consistently emphasizes the need to address these characteristics of climate risk and serves as a catalyst for convening thought leaders on the subject, while also taking concrete action in its own market.

In 2018, the UK partnered with the City of London to develop a Green Finance Institute, to shine a spotlight on the nation as a center of sustainable finance. The institute includes members from the Bank of England, the Taskforce on Climate-related Financial Disclosures, the London Stock Exchange, and several other investment firms and think tanks. While it may be more symbolic than substantive, the creation of this institute demonstrates the UK's favorable stance towards integrating climate considerations into the financial system.

KEY ACTIONS

Guidelines for Insurance Stress Tests—In June 2019, the PRA released Scenario Specification, Guidelines and Instructions for life insurance and general insurance stress tests including both physical and transition climate risks. The guidance lays out potential impacts by providing sector-specific percentages of potential loss under three scenarios by sector and by region. These quantitative financial impact assumptions are not a projection but a starting point for the insurance industry to explore potential impacts of climate change on their portfolios. This "exploratory" exercise is an enormous step towards catalyzing a growing understanding of possible impacts of transition and physical climate risks on financial assets.

Insurance Working Group Guidance on Financial Impacts of Climate Change— In May 2019, the PRA's working group of insurance industry experts released a framework for assessing the impacts of physical climate change in the insurance sector. It outlines a six stage process: identify the business decision the assessment will inform to determine time horizon; identify the business area in which climate change has material impacts; explore existing analysis of the impact of climate change on extreme weather events; survey potential tools for identifying risk exposure; assess financial exposure and potential impact, accounting for uncertainty; and communicate assessment results, including the intended action. The working group is seeking emailed feedback by Nov. 22 2019.

Supervisor Statement on Managing Climate Risk—In April 2019, the PRA released the final Supervisory Statement (Statement) 3/19 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change.' The document addresses comments made on the draft Statement during a consultation period and applies to all insurance and reinsurance firms, banks, banking societies and PRA-designated investment banks. It mandates that these firms must integrate the financial risks of climate change into their governance and risk management, use long-term scenario analysis, and develop a climate risk disclosure process. Firms must have an initial plan to address these requirements by Oct. 15 2019, but the PRA emphasized its expectations for practices to evolve over time and its plans to release more detailed guidance accordingly.

PRA & FCA Climate Financial Risk Forum— A group of banks, insurers, asset managers, and other financial stakeholders will meet three times a year to promote capacity building and knowledge sharing for responding to financial climate risks. The PRA and the Financial Conduct Authority (FCA) hosted the group's first meeting in March 2019. The Forum will establish four working groups to collate guidance on risk management, scenario analysis, disclosure, and innovation.

Market Survey—The PRA surveyed the bank and insurance sectors on their exposure to physical risk and how they address it. The insurance report from 2015 highlights past losses due to extreme events, alongside projections for changing events. For example, "According to the Munich Re natural hazards catalogue, between 1980 and 2014, river floods accounted for 41% of all loss events, 27% of fatalities and 32% of losses. Changes to the timing and amount of precipitation have the potential substantially to alter flood regimes and therefore future flood losses."

The 2018 banking survey found that 90% of surveyed banks identified examples of credit risk caused by climate change, 70% identified operations risk, and 20% identified market risk. Additionally, 8.8% of current mortgages are in a flood risk zone, and this will likely increase due to climate change. By performing this high-level industry-wide risk assessment, the PRA helped to provide an idea of the scale of risks for one hazard for one sector, while also prompting individual banks to conduct more detailed analyses of their own mortgage portfolios.

STAY TUNED

Banks and insurance firms are expected to have their initial plans for addressing the supervisory statement on financial climate risk by **Oct. 15 2019.**

Email feedback on the framework for assessing the impacts of physical climate change, to the Insurance Working Group by **Nov. 22 2019**.

The Bank of England has committed to disclosing how it manages climate risk in line with the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations in its 2019/2020 annual report.

ABOUT FOUR TWENTY SEVEN

Four Twenty Seven (427mt.com) is the leading provider of market intelligence on the impacts of climate change for financial markets. We tackle physical risk head on by identifying the locations of corporate production and retail sites around the world and their exposure to climate change hazards such as sea level rise, droughts, floods and tropical storms, which pose an immediate threat to investment portfolios.

Four Twenty Seven's ever-growing database now includes one million corporate sites and covers over 2000 publicly-traded companies. We offer subscription products and professional services to access this unique dataset. Options include data licenses, an interactive analytics platform, and company scorecards, as well as reporting services, scenario analysis, and real asset portfolio risk assessments.

Four Twenty Seven has won multiple awards for its innovative work on climate risk and resilience and our work has been featured by Bloomberg, the Financial Times and the UNFCCC. Four Twenty Seven was founded in 2012 and is headquartered in Berkeley, California with offices in Washington, DC and Paris, France.

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