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CP10/25, Central Climate Team
Prudential Regulation Authority
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London
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Also sent via email to CP10_25@bankofengland.co.uk

30 July 2025

Dear Central Climate Team,

ShareAction submission to CP10/25 – Enhancing banks' and insurers' approaches to managing climate-related risks – Update to SS3/19

I am writing to respond to the Prudential Regulation Authority (PRA)'s Consultation Paper 10/25 on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices throughout the financial services sector.

We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. Among other activities, we work with the financial services sector, including asset management firms, to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the views of clients, beneficiaries and pension scheme members.

ShareAction welcomes the opportunity to comment on the UK PRA's draft Supervisory Statement on Enhancing banks' and insurers' approaches to managing climate-related risks. ShareAction supports the PRA's intention to update and clarify its supervisory expectations in light of growing climate-related risks and the consequent need for firms to progress their risk management capabilities, and welcomes the PRA's aim to build on lessons learnt in the UK and internationally over the last five years on firms' management of climate-related risks.

We welcome the updated provisions set out in the consultation document and appreciate the improvements that they represent, especially in a global political context where, in various places, governments seem to backtrack from previous commitments to halt or mitigate climate change and appropriately deal with climate related risks. However, we also note that most of the changes proposed by the PRA clarify rather than enhance the supervisory expectations, and we observe some limitations in terms of: 1) the overall approach taken to understand and tackle climate-related risks; 2) the micro- and macro-prudential tools proposed to manage those risks; 3) the enforcement of the proposed supervisory expectations; and 4) the alignment with international and EU standards.

Overall, we encourage the PRA to continue to take climate-related risks and financial stability seriously, but to go further and: adopt a precautionary systemic risk approach to avoid the build-up of climate-related risks in the first place (section 1); take micro and macroprudential measures to ensure

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that individual banks and insurers, and the financial sector as a whole, are better equipped to deal with such risks (section 2); implement robust enforcement measures (section 3); and better align its practices with international and especially EU standards (section 4).

We hope these general comments, as well as comments on specific chapters of the consultation, will be helpful.

General comments

1. A systemic risk perspective

Besides its price stability objectives, the Bank of England has a financial stability objective aimed at protecting and enhancing the stability and resilience of the financial system of the United Kingdom. The PRA, as the microprudential regulator of banks, building societies, credit unions, designated investment firms and insurers (hereafter: banks and insurers), must take into account financial stability considerations when advancing its general objective to promote the safety and soundness of the firms it regulates.

It is therefore logical for the PRA to approach climate change from a single materiality perspective, i.e. to focus on banks' and insurers' ability to monitor and manage climate-related risks, in order to ensure they remain sound and can face future losses. However, the focus on managing the financial risks (for banks and insurers) linked to their exposure to physical and transition risks (due to climate change and/or the wider societal and regulatory actions taken to fight it or in reaction to it) is too narrow.

Indeed, insurers' and banks' activities, such as their continued investments in activities that lead to the burning of fossil fuels (see Banking on Climate Chaos report), are themselves contributing to climate change, and therefore contribute to the buildup of climate related risks (physical and transition risk) in the financial sector in the first place. Those risks in turn can threaten individual firms and the sector as a whole – highlighting the 'endogeneity of environmental-financial risks' (Kedward et al., 2021). It is therefore important for the PRA to also consider how the firms it regulates could be incentivised or required to reduce their own negative impact on people and planet, because the feedback loop effect of those impacts means they create additional risks affecting the financial sector. As Dafermos et al. (2024) put it, 'from a systemic perspective, the more central banks and financial supervisors help reduce the adverse environmental effects of economic activities [e.g. reduce the negative environmental materiality of the financial system], the lower the risks posed to the financial system' (Dafermos et al. 2024, p.1). Or, as explained in the case of insurers: 'risk transmission does not only flow one-sidedly from the climate to individual insurers: if insurance companies keep financing or insuring the development of high-carbon projects, they are contributing to ever-greater physical climate risks and thereby compounding future losses for themselves and their peers' (Mack 2025).

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Given that climate change and related risks are now widely recognised as being systemic (including by the PRA) with potentially far-reaching impacts on financial stability, such an approach would be firmly within the remit of the Bank, and especially the Financial Policy Committee which is responsible for 'identifying, monitoring and taking action to remove or reduce systemic risks' (BoE), and would also fall within the scope of the PRA's work insofar as it 'must take into account financial stability considerations when advancing its general objective to promote the safety and soundness of the firms it regulates' (BoE).

We therefore recommend that the PRA adopts such a systemic risk perspective, which 'seeks to reduce financial institutions' contribution to negative environmental externalities because of the systemic financial risks that could result from them' (Inspire/SOAS/LSE 2022, p.6-7 especially).

One way of ensuring a reduction of financial investments to harmful activities would be for the PRA to require firms to adopt robust climate goals, for example absolute emission reduction targets, via supervised and effectively enforced transition plans. This is, for example, the approach recommended by Dikau et al. (2021) and Robins et al. (2021), who suggest that prudential supervisors should make net-zero a central element of their supervisory practice, and should require regulated financial institutions to submit net-zero transition plans, including clear steps to reduce fossil fuel exposure.

In the EU, the Corporate Sustainability Due Diligence Directive (CSDDD) already requires companies in its scope to adopt and implement climate transition plans aligned with the Paris Agreement, while the Corporate Sustainability Reporting Directive (CSRD) requires the disclosure of those plans. The UK Government for its part has committed to net-zero in 2050 and its Manifesto committed to the introduction of mandatory transition plans (cf. ongoing consultation on this topic). Therefore, if the PRA were to agree that mandatory transition plans for banks and insurers are necessary on prudential and financial stability grounds, this would fit with wider UK government policy and would align UK regulation with that of the EU, thus enabling a more level playing field.

2. A precautionary approach making use of micro and macroprudential tools

Following on from the above, and from the PRA's own recognition that climate-related risks are systemic and with impacts that will 'likely be correlated, non-linear, irreversible and subject to tipping points' (PRA CP, p.4), the PRA should complement its supervisory expectations with enforceable tools that would a) increase the resilience of individual firms in the face of risks that are 'likely to occur on a greater scale than other risks that firms are used to modelling and managing' (PRA CP, p.4); and b) increase the resilience of the UK financial sector as a whole.

Microprudential tools

Capital requirements are a key tenet of prudential regulation and a pillar of financial stability. However, given the novel, complex, unique and forward-looking nature of climate-related risks, those risks are not yet fully or adequately captured in the current calibration of capital

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requirements. Indeed, climate change and the climate transition are ongoing, unprecedented and radically uncertain events, and as such, their effects have not been 'captured' in historical events and by past indicators and data, on which relies much of the traditional backward-looking methodology to assess risk and calibrate microprudential regulation.

Given the urgency of the climate crisis and the evidence that the burning of fossil fuels in particular is the main cause of climate change, the PRA, or the Bank of England in coordination with the PRA, should as a matter of priority re-assess the calibration of capital requirements linked to fossil fuel-related assets, to make sure that firms that choose to invest in fossil fuels remain adequately capitalised in the face of the physical and transition risks they are exposed to.

Robust mandatory transition plans could also be used to adjust individual firms' capital requirements, for firms found to be deviating from a 1.5 aligned trajectory and therefore exposed to higher levels of transition risks.

If the UK considered capital requirements that better reflect physical and transition risks, it would not only be aligning with the most precautionary approaches to the microprudential supervision of climate-related risks, but would also likely contribute to a more level playing field in Europe, given that similar changes are under consideration in the EU. Indeed, the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) have been mandated to assess whether a dedicated prudential treatment of exposures related to (banks' and insurers') assets associated substantially with environmental and/or social objectives or harm to such objectives would be justified. The European Commission just this month confirmed that:

> *The European Commission, together with EIOPA, will assess how* ***sustainability risks related to fossil fuel assets and activities****, including transition risks currently associated with high emissions but on a trajectory towards alignment with the Paris Agreement objectives, are managed by insurance and reinsurance undertakings****. If appropriate, the Commission will consider possible amendments to ensure that these emerging risks are adequately reflected in the prudential framework****, taking into account developments in the framework for credit institutions, as well as the report delivered by EIOPA pursuant to Article 304c(1) of Directive 2009/138/EC.*
> (European Commission, review of technical rules (Solvency II), proposal for a delegated regulation, 17 July 2025)

The EIOPA report that the Commission refers to above found that fossil fuel-related stocks and bonds held by insurers present an elevated risk profile which warrant additional capital requirements. EIOPA thus recommended a targeted capital surcharge specifically for fossil fuel-related corporate bonds and equity investments on European insurers' balance sheets to accurately reflect the high risks of these assets. EIOPA's Board of Supervisors – representing the insurance supervisors of all EU member states – deemed this proposal a 'robust mechanism to better align capital requirements with their risk exposures' and a 'pragmatic approach for enhancing financial

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resilience of the insurance sector' (Cover Letter on the Report on the Prudential treatment of sustainability risks in Solvency II, November 2024).

Although this work refers specifically to EU insurers, UK insurers and banks are also investing in fossil fuel related assets and are therefore likely exposed to levels of risks that have so far been underestimated. The recently announced review of the overall level of capital requirements for UK banks (Financial Stability Report, July 2025) should be the occasion to specifically and urgently re-assess, and recalibrate as a matter of priority if needed, the capital requirements for fossil fuel related exposures.

Another measure that the PRA should start exploring is the imposition of quantitative restrictions or caps on lending towards activities that most clearly contribute to climate change and environmental degradation, such as unconventional fossil fuels and fossil fuel expansion (see Kedward et al. 2022). This would ensure that the negative impact of a few financial institutions' investment decisions, and higher systemic risks that the entire sector and the wider economy face as a consequence, are effectively reduced.

Macroprudential tools

Given the systemic nature of climate related risks, and the complex interconnections, interactions and feedback loops that existing between and across financial institutions in the UK financial sector and worldwide, the microprudential approach detailed above should be complemented with a macroprudential approach. The PRA should explore the application of macroprudential tools such as systemic risk buffers and concentration limits (see for instance ECB 2024, ECB and ESRB 2022) which are already part of the established macroprudential policy framework and are well-suited to targeting sector-wide vulnerabilities that stem from common exposures and correlated risks — precisely the characteristics of climate-related financial risk acknowledged by the PRA itself.

Systemic risk buffers, including the Global Systemically Important Institutions (G-SII) and Other Systemically Important Institutions (O-SII) buffers, could be adapted or newly designed to account for systemic climate risk. For example, a dedicated climate systemic risk buffer could be applied to systemically important banks or insurers with disproportionately high exposures to activities or assets that contribute most to climate-related risks, such as fossil fuel extraction, production, and infrastructure. This would help mitigate the broader financial stability risks that could arise from disorderly transitions, asset stranding, or the materialisation of severe physical risks.

Similarly, **concentration limits** could be introduced to curb excessive exposures to climate-relevant sectors, particularly where those exposures are large enough to create or amplify risks to the broader system. For instance, exposures to high-risk fossil fuel sectors (e.g. coal, tar sands, or new oil and gas exploration) could be subject to explicit caps or thresholds, with regulatory consequences triggered when breached. This would not only incentivise the diversification of firms' portfolios away from high-risk climate-harming assets, but also limit the propagation of correlated losses across the financial system.

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Such measures would be consistent with the precautionary principle and would reinforce the PRA's ability to act in the face of deep uncertainty and long-time horizons. The European Systemic Risk Board (e.g. in 2023), but also EU national banking supervisors such as De Nederlandsche Bank (here in 2022) have already pointed to the usefulness of concentration limits and /or systemic buffers as part of the macroprudential response to climate risk. By proactively integrating these tools, the PRA could enhance the resilience of the UK financial system and ensure it is better equipped to withstand the financial impacts of accelerating climate and environmental change.

3. Enforcement mechanisms

As the PRA states, the proposals under consultation 'consist of supervisory expectations for effective risk management practices rather than rules for banks and insurers to follow'. However, it remains unclear how the PRA will make sure that its expectations are met, and what consequences individual firms will face should they fail to meet them, or even fail to take appropriate measures towards meeting them. This is problematic because it could mean that the enhanced supervisory expectations are not followed by better practices nor better outcomes overall.

On this point, we would recommend the PRA to adopt a model similar to the 'escalation framework' used in ECB banking supervision. The escalation process starts with identifying potential shortcomings or breaches but also includes more compelling tools such as sanctions (on banks and members of their decision-making bodies), which are considered 'a cornerstone of credible and effective supervision' (ECB 2025).

When it comes to supervisory expectations and related sanctions on the management of climate related risks, the ECB (June 2025) finds that European banks have made significant progress in addressing the risks stemming from the climate and nature crises, and that this can be partly explained by the threat of financial fines. In 2022, almost 80% of European banks had either only basic climate-related and environmental risk management practices in place or none. The ECB thus set interim deadlines for 2023 and final deadlines for the end of 2024. By the first interim deadline (March 2023), the ECB issued 22 threats of periodic penalty payments (PPPs) if banks failed to meet the requirements set out in the ECB decisions. By the second interim deadline (end-2023) concerning the integration of climate and environmental risk into banks' governance, strategy and risk management, only nine banks received binding ECB supervisory decisions, including the potential imposition of PPPs. For some banks, the process to determine whether PPPs have accrued is still ongoing. With regards to the final deadline (end-2024), when banks were asked to include climate-related and environmental risks in their stress testing and internal capital adequacy assessment processes (ICAAPs), the ECB is still finalising its assessment but has already noted that the number of banks not meeting its key expectations decreased even further (ECB, June 2025). Thus, although evidently additional factors have come into play, it seems the ECB's approach has led to improved practices on the part of European banks.

At a time when the ECB demonstrates rigorous enforcement (with an increase by 19% in sanctioning proceedings compared with the previous year, and fines totalling €27.9 million across supervised

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entities, according to the 2024 annual report on the sanctioning activities of the ECB and National Competent Authorities), the PRA should at the very least work to strengthen its enforcement mechanisms, and consider making use of financial penalties to better incentivise firms to meet its expectations and further deter against future violations or suboptimal practices.

4. Alignment with EU and international standards

First, we recommend that the PRA follows other central banks (such as the ECB or the German BaFin) in considering environmental risks in addition to climate related risks throughout its supervisory expectations, and in particular nature-related financial risks.

Second, the PRA could better align with some of the specific points made by the ECB in its 2020 supervisory expectations on climate-related and environmental risks:

- The ECB's expectations provide far **more detail on the type of climate-related and environmental risk drivers**, as well as examples of these. In the PRA's proposal, this information seems scattered across the definition of climate-related risk (Chapter 2) and sector-specific issues (Chapters 6 and 7). While the spirit of guidelines is not to provide exhaustive lists of risks that should be considered, an insufficient level of detail creates a risk that financial institutions take a rather narrow-minded approach to potential climate-related risks and risk drivers. We recommend including more explicit examples of outlier scenarios / long tail risks in Chapter 2 or in the sector-specific chapters.
- Similarly, unlike the ECB's expectations, the PRA's proposal does not refer to **international frameworks that management bodies should consider in order to achieve a holistic approach to risk**. As the PRA's standard acknowledges in other places (e.g. in paragraph 2.4), transition risks due to the timely or late application of international agreements to government policies can be significant. By explicitly integrating international frameworks (such as the Paris Agreement) into the expectations, management bodies can be expected to factor in this uncertainty.
- In its risk management framework, the ECB expects firms to conduct **proper climate-related and environmental due diligence at inception and on an ongoing basis**. We would welcome the UK PRA to explicitly include a similar due diligence requirement (e.g. in chapter 6 and 7) to check on counterparties' on-demand or ESRS/UKSRS-based reporting for soundness, as incomplete, outdated or erroneous reporting could expose the financial institution unexpectedly to climate-related risk.
- The PRA's proposals on **reputational risk**, in section 4.6.32, could also be improved. While we recognise that consumer preferences in terms of exposure to activities that contribute to climate change, such as loans to firms engaging in new fossil fuel exploration, might differ, the current text too easily allows banks to dismiss these considerations as cancelling each other out in terms of risk. Reputational risk is far more complex than just customer sentiment in terms of transmission channels, e.g. when consumers as citizens demand political intervention in sectors supported by the bank. In addition, consumer boycotts in other sectors have shown

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that these can bankrupt firms, and in the financial system there are spillover effects (e.g. in case of a bank run) that could have consequences for financial stability. We recommend the PRA to investigate the more granular form of reputational risk classification, e.g. as recommended by the ECB in expectation 9.2 (see also the case study in Box 10 of the ECB's 2020 expectations).

Chapter-specific comments

Chapter 1 - Governance

Overall, ShareAction welcomes the PRA proposals on governance. As mentioned above however, we do find it insufficient that 'the PRA does not require firms to adopt climate goals, for example net zero emission targets or adaptation goals' (cf. Section 1 - A systemic risk perspective).

In addition, regarding 4.1.6, 'where a firm adopts [climate] goals or targets, the firm should be able to demonstrate, upon request, how its plan to meet those goals and targets, including the assumptions underpinning these plans, are integrated into a firm's overall strategy', we fully support the PRA's view that climate commitments should be followed by actions and should therefore be reflected in the firm's overall strategy (notably in order to tackle greenwashing and preserve trust in financial institutions). However, as long as there are no requirement for all banks and insurers to develop and implement a transition plan with clear climate goals or targets, the risk is that the proposed requirement (only applying to those who *voluntarily* adopt climate goals) has a chilling effect, i.e. firms might be less willing to adopt climate goals and disclose them for fear of then falling short of adequately integrating them into their overall strategy. The conclusion should not be that this requirement should not exist, but rather this logic reinforces the need for a level playing field across banks and insurers, and for robust mandatory transition plans for all financial institutions.

Chapter 2 - Risk management

Overall, ShareAction welcomes the PRA proposals on risk management – although as mentioned in the sections above, more could be done to ensure improved practices and a more stable financial sector.

While we welcome at 4.1.4 the proposal that 'the board should ensure mechanisms are put in place for the periodic review of the firm's strategy for addressing climate-related risks, its risk appetite and risk management practices', we believe it is too vague to let the 'frequency of the review to be determined by the climate-related risks the firm is exposed to, firm's business model and the geographical concentration of its balance sheet' as it could lead to irregular reviews that fail to capture new risks or rapidly increasing risks, and thus fail to lead to the related necessary adjustments.

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Chapter 3 - Climate scenario analysis

ShareAction welcomes the added clarity on embedding climate scenario analysis (CSA) into governance, metrics, disclosure and capital planning, and the call for a wider use of reverse stress testing. We also agree with the PRA's recognition that there are inherent data limitations and uncertainty which firms should clearly communicate when presenting their CSA results.

However, to avoid systemic under-preparedness, the PRA should:

- Explicitly consider extreme 'hot house', high-temperature (> 3°C) and disordered/delayed transition trajectories. Currently, the PRA relies heavily on NGFS-type economic models, which have limitations (see NGFS & FSB, November 2022; or ECB Climate Risk Stress Test, 2022) including the fact that they underestimate long-term economic losses, particularly in high-temperature, disordered or delayed transition pathways. As the Institute and Faculty of Actuaries (IFoA) and University of Exeter recently highlighted, existing economic damage models (e.g. 2% loss for a 3°C rise) could be dangerously misleading and insufficient in capturing tail risks and tipping-point dynamics.
- Anchor CSA in scientific evidence and precautionary principles. There is currently insufficient linkage between climate science and scenario design, and the PRA could more explicitly require embedding scientific consensus (e.g. IPCC physical risk pathways) qualitatively into CSA design and explicitly require firms to assume worst-case tipping points or catastrophic outcomes in CSA.

I hope our views are clear, but please do not hesitate to contact us if you have any questions.

We look forward to further opportunities to share our views and discuss them with you.

Yours sincerely,

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