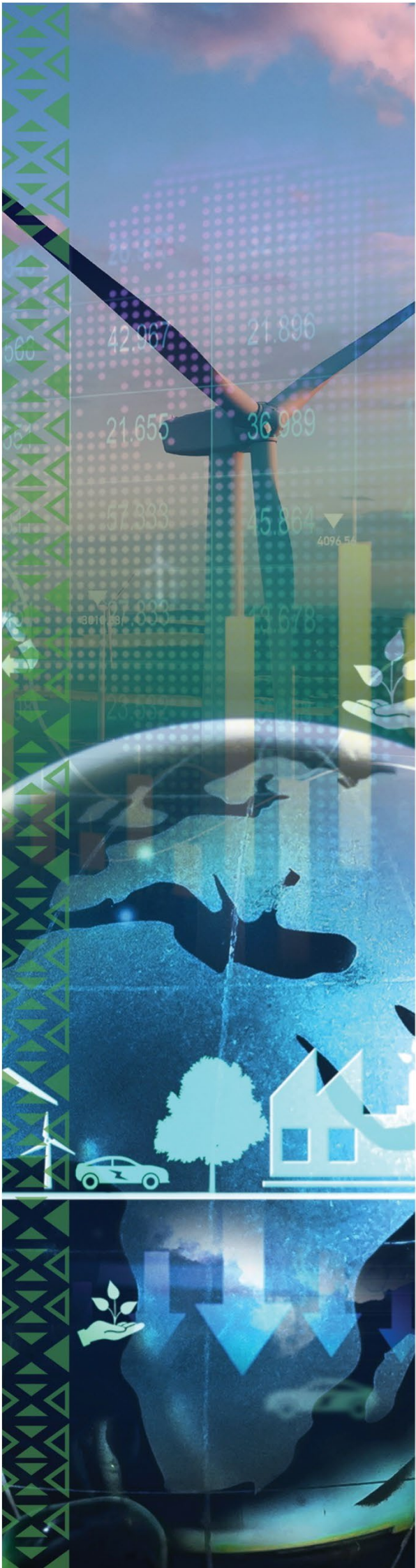


Climate Risk Practices Observation Report



SOUTH AFRICAN RESERVE BANK
Prudential Authority





Climate Risk Practices Observation Report

Observations from the 2023 flavour-of-the-year discussions on climate-related risks with boards of directors and senior management of banks, including foreign branches, and insurers, including reinsurers.

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Executive summary

Climate-related risks were discussed with 22 selected financial institutions regulated by the Prudential Authority (PA) in the 2023 calendar year as a ‘flavour-of-the-year’ topic. This observations report provides high-level feedback on the discussions held and is for informational purposes only. This report does not constitute regulatory guidance or supervisory expectations. The PA believes this information to be useful for banks and insurers as they expand and deepen their understanding, practices and risk management approaches to climate risks.

The PA was encouraged at the level of detail presented and the rich discussions, which showed that considerable progress is possible despite the challenges. Overall, both banks and insurers indicated that they were at the beginning of a journey in climate risk management and in relatively early stages of quantifying climate risks. The focus had been on knowledge building, data gathering for risk identification and disclosures, and to a lesser extent on climate scenarios. All institutions indicated their approach to embed climate risks within existing risk management frameworks and to leverage existing governance frameworks.

In the banking sector, the implementation of risk classification measures and tools was varied. Most of the banks presented their concentration limits or thresholds for balance sheet exposures to climate-sensitive sectors. All banks indicated that further work was needed, particularly with calculating Scope 3 or indirect, financed emissions. Most, but not all banks, have developed a climate risk appetite considering various factors such as an alignment to science-based greenhouse gas (GHG) emission targets and stewardship. Banks were developing their capabilities to assess and quantify the impact of physical and transition risks using scenario analysis and stress testing, focusing on credit and market risk. Work on transition plans and pathways was nascent and discussed with some level of hesitation, given policy uncertainties as well as data quality and the availability challenges.

The implementation of risk classification measures and tools varied within the insurance sector, with life insurers mostly advancing on transition risks and non-life

insurers, as expected, focusing on physical risks. Some insurers have started to develop thresholds and concentration limits for certain sectors; however, all indicated that more refinement and development were needed.

At board level, climate risk was predominantly integrated into existing risk and social and ethics committees. At executive and operational level, there were examples of dedicated climate committees with a focus on specific areas such as climate data and scenarios. Some institutions included climate risk within committees with a broader mandate covering sustainability and social risks.

All banks and most insurers reported using the Task Force on Climate-related Financial Disclosures (TCFD) framework for public disclosures, noting that the TCFD framework had recently been incorporated in the International Sustainability Standards Board's (ISSB) climate-related disclosure standard. Banks and insurers also reported using other frameworks and highlighted the need to keep vigilant of international developments and the plethora of standards and frameworks being developed. Boards were cognisant of greenwashing, reputational risks and climate-litigation risks.

There was a convergence of views on the main challenges and issues. The availability, reliability and quality of granular data remained key challenges. Challenges beyond data availability and quality included expertise and skills to perform scenario analysis and climate-risk modelling. The long-term scenarios could be challenging to interpret and together with the lack of industry guidance and standardised methodologies it was difficult to assess the financial impact of climate change. The unique and complex characteristics of climate-related risks (i.e. lack of historical precedent, interconnectedness, high degree of uncertainty and potentially longer time horizon) made risk management in general and scenario analysis in particular challenging. Where scenario exercises had been undertaken, the results were thus presented and used with caution given the challenges.

The information will help inform the PA's regulatory and supervisory approach to climate risks within a broader sustainable finance agenda.

1. Background

Annually, the Prudential Authority (PA) considers significant industry developments that affect regulated institutions and require additional focus and understanding from a supervisory perspective. The topic(s), selected through the PA's governance processes, are communicated to regulated institutions at the beginning of the year and are referred to as 'flavour-of-the-year' (FOTY) topics. The FOTY topics are included as an agenda item for discussion in the annual supervisory meetings with the boards of directors (boards) and senior management (or country/branch oversight committees in the case of foreign branches). The discussion is not intended to be exhaustive and technical; rather it is high level to get an idea or flavour of the boards' views and approaches.

In the 2023 calendar year, there were two FOTY topics – organisational resilience and climate-related risks (herein onwards referred to as climate risk(s)). The decision was made to discuss climate risk with a limited number of institutions (22) as climate risk management frameworks were nascent and required specialist skills, capacity and data. The choice of climate risk as a FOTY topic followed the PA's focus on climate risks through the work of an internal working group called the PA Climate Task Team (PACTT). The PA undertook a few surveys – one on climate disclosures and risk practices in 2020¹ and a climate risk survey in 2021² – to obtain an initial level of understanding of the industry's response to these risks. In 2022, the PA communication on climate risks³ signalled its interest and intent towards the integration of climate risks within the regulatory and supervisory mandate. In August 2023, the PA published for comment four draft guidance notices (GNs) on climate-related disclosures, governance and risk practices for banks and insurers.

¹ See Survey Results: Task Force on Climate-related Financial Disclosures (TCFD):

<https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-public-awareness/Financial-Sector-Awareness/9855>

² See Prudential Authority 2021 Climate Risk Survey Report:

<https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-public-awareness/Financial-Sector-Awareness/Prudential-Authority-Climate-Survey-Report-2021>

³ See Prudential Communication 10 of 2022 on Climate-related risks:

<https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-public-awareness/Communication/2022/Prudential-Communication-10-of-2022-Climate-related-Risks>

This document provides feedback on the discussions held and is for informational purposes only. This report does not constitute regulatory guidance or supervisory expectations. The discussions were brief and focused on a holistic approach to climate risks, without going into extensive details. This report does not identify or name any specific institution. Supervisory feedback letters were provided to the selected institutions post these engagements.

2. Introduction

This report covers the board-level discussions on climate risks held during 2023 with eight banks, including branches of foreign banks, and 13 insurers, including reinsurers.⁴ Boards were requested to present their respective institution’s views, strategies and actions undertaken or planned to address climate risks.⁵ Specifically, the boards were asked to present on their approach to climate risks and opportunities in the following thematic areas:

Figure 1: Thematic areas of discussion

Climate risk: Board-level discussion			
Governance, leadership and strategy	Risk management	Scenarios and stress testing	Disclosures and reporting

A summary of the discussions is provided in this report, with a focus on climate risks. This report provides an illustration of the range of practices observed, with notable examples identified from the discussions and presentations. Additional considerations are included in relation to international standard-setting organisations, namely the Basel Committee on Banking Supervision’s (BCBS) Principles for the management and supervision of climate risks, the International Association of Insurance Supervisors’ (IAIS) application paper on the supervision of climate risks and the PA’s GNs on climate-related disclosures, governance and risk practices.

⁴ A Board discussion was held with one financial market infrastructure institution, which is not included in this report.

⁵ See Prudential Guidance Note 2 of 2023, Flavour of the year topics: <https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-deposit-takers/banks-guidance-notes/2023/G2-2023-Flavour-of-the-year>

The management of climate risks is currently evolving, and practices are expected to mature over time. The PA believes this information to be useful for banks and insurers as they expand and deepen their understanding, practices and risk management approaches to climate risks.

3. Governance, leadership and strategy

The PA asked boards to present their understanding of climate risks and how these were considered within their respective institution's strategy. In addition, boards had to describe the roles and responsibilities for managing climate risks as well as their relevant capacity-building and training initiatives.

3.1 Range of practices

Banks

In general, the discussions showed a growing awareness and understanding of climate risk at board level. The boards spoke about the impacts of climate change and the physical and transition risks the banks had to face. The banks recognised climate risks as a cross-cutting and transversal risk, which amplified other primary risk types. Furthermore, the banks in general recognised and categorised climate risks as urgent or strategic, global and a systemic, material risk. Institutions broadly presented a double materiality approach, looking at the impact of climate risks on their clients and their operations as well as their impact on climate change. All institutions indicated a need to actively monitor local and international standards, regulations, policies and related publications, and to a varying degree were cognisant about third-party liability and climate-litigation risks.

Banks reported that climate risks and opportunities were recognised within a broader environmental, social and governance (ESG) and sustainable development goals (SDGs) or sustainability agenda and were embedded within their overall business strategy. All banks had set targets to reach net zero emissions by 2050 on Scope 1, 2

and 3 GHG emissions.⁶ Some institutions had set earlier targets for reaching net zero emissions in their own operations, and for zero exposures to fossil fuel-related activities.

All institutions indicated training at board level, executive level and for staff, with some institutions having started training with specific teams, while others started rolling out climate-related training to all employees. Some banks used the construct of three lines of defence – client-facing, risk function and internal audit – to roll out relevant and appropriate training to each group.

Most banks reported climate matters to both the risk committee and the social and ethics committees. One bank had a dedicated board subcommittee on climate risk. There were examples of additional reporting to the audit committee regarding disclosures, the remuneration committee regarding key performance indicators and a committee looking at large credit exposures and concentration risks. It was noted that dual membership of committees and regular communications between committee chairs were used to ensure some level of coordination and comprehension. At an executive management level, all but one bank had a dedicated committee looking at climate risks – either as a single focus, or within an ESG or sustainability committee. Technical committees varied from a broad sustainability focused working group to specific working groups looking at climate data and systems. Foreign branches had access to larger internationally based climate technical expertise.

Insurers

The boards of insurers generally portrayed a reasonable level of awareness and understanding of climate risks and their potential impacts on insurers' strategies and business plans. Climate risk was mostly highlighted as a risk that could have a material impact on insurers' business models, strategies and own operations and warranted additional attention and understanding. Climate risk was seen to be a transverse risk

⁶ Scope 1 refers to all direct GHG emissions; Scope 2 to indirect GHG emissions from consumption of purchased electricity, heat, or steam and Scope 3 to other indirect emissions not covered in Scope 2 that occur in the value chain of the reporting company, including both upstream and downstream emissions. Relevant Scope 3 emissions for finance sector entities include Scope 1, Scope 2 and material Scope 3 emissions from businesses to which they have a financial exposure (e.g. through lending activities, insurance products and investments), or the Scope 3 emissions of emissions-intensive inputs to their businesses.

affecting most of the traditional risk categories and was thus integrated into existing governance frameworks and structures.

Climate risk was integrated into existing board committee structures such as audit, social, ethics and risk and compliance committees. The scope of these committees had been extended to include climate risk explicitly or as part of the wider ESG considerations. We noted several training initiatives for board members to enhance their understanding of climate risks. In some cases, insurers also started to provide support and education to their clients in terms of good risk management and mitigation practices. At an executive management level, some insurers had dedicated climate risk or sustainability committees. In some cases, performance targets and remuneration considerations included ESG criteria and metrics.

Insurers considered climate risk within their strategies over various time frames. Life insurers indicated more significant impacts over the medium and long term while non-life insurers presented more concern over the short-term impacts. Some but not all insurers had considered the impact of climate risk on their operations and supply chains. Generally, insurers considered climate risk from various perspectives, namely as asset owner, investor, underwriter or risk taker; risk mitigator and manager; and as business with operations and supply chains.

3.2 Notable examples and considerations

While some board members displayed a thorough and comfortable understanding of the topic and could engage on nuanced topics, other board members presented the information in a methodical way. Boards should understand and evaluate the impact of climate-related risks on their respective bank's business model which includes understanding and assessing a bank's exposure to structural changes in the economy, financial system and competitive landscape in which the bank operates.⁷ Similarly, for insurers, the board has a role in maintaining effective oversight of climate risk management, including incorporating climate-related considerations into the insurer's

⁷ Basel Committee on Banking Supervision, *Principles for the effective management and supervision of climate-related financial risks*, June 2022, www.bis.org/bcbs/publ/d532.pdf

risk appetite, strategies and business plans.⁸ Board members with exposure and an understanding of international developments related to climate risks, showed an increased awareness of the shift from voluntary to regulatory reporting requirements and the increased role of scenario analysis in developing forward-looking, long-term perspectives.

Climate risks may manifest through traditional risk categories yet have unique risk characteristics that require a more gradual and forward-looking perspective that recognises the high degree of uncertainty, the potentially longer time horizon and the unprecedented nature of climate risks relative to other types of risks. There are thus benefits to reporting within and across existing committee structures but also potential benefits for a dedicated focus within one committee. Boards may consider periodic reviews of their structures to ensure they are fit for purpose.

Regardless of the committee structures, the approach established by the board would filter down throughout the institution. Apart from the board training provided, the institutions generally did not specify board members with climate-related experience. Most institutions communicated a clear top-down endorsement of their climate strategy, while others expressed some reservations and trade-offs that appeared short term in nature. Although most boards actively engaged on the topic and highlighted the importance of increasing their understanding through appropriate training and upskilling initiatives, some boards appeared reluctant to address any shortcomings due to challenges around data, the lack of quantification methodologies and lack of regulatory requirements.

4. Risk management

The PA requested institutions to present their risk appetite in relation to climate risks and how they integrated climate risks into their risk management process. This included the process of identifying, assessing, measuring, monitoring and responding to climate risks as well as how these are reported to appropriate risk and governance

⁸ Application Paper on the Supervision of Climate-related Risks in the Insurance Sector (IAIS)

committees, taken into consideration the implications of international standards and regulations.

Scenario analysis and stress testing are important tools in the risk management process to establish the impacts on portfolios and sectors. This is discussed separately in the next section given their complexities and challenges.

4.1 Range of practices

Banks

The banks all indicated that climate risk management was a work in progress, and they were working on developing additional metrics and tools over time. In general, the discussion showed that there was widespread awareness of the strategic importance of these risks, but challenges to account for the risks due to data limitations and uncertainty in climate models, particularly over long-term horizons. The data challenges were exacerbated in African operations outside of South Africa.

Not all the banks had a climate risk appetite statement. Some banks included climate risk appetite within an overall risk appetite, while most banks presented specific climate risk appetite statements incorporating qualitative and quantitative aspects. All banks were looking at credit risk implications, with some considerations for operational, market and reputational risks, and very limited consideration of the impact of climate risks on other risk types. Due diligence and credit risk screening practices ranged from still being under-developed to part of an ESG component and/or bespoke climate risk and carbon assessment tools.

Some institutions presented initial steps to integrating climate risks in their investment process and portfolio monitoring. Some have documented basic climate-related exclusion criteria and have developed qualitative scores or heatmaps to assess risk concentrations. Most institutions mentioned that calculating financed emissions was a work in progress and expressed reservations and concerns about using proxy data or third-party data sources.

The implementation of risk classification measures and tools was varied. Most of the banks presented their concentration limits or thresholds for balance sheet exposures to climate sensitive sectors. These sectors ranged from coal and fossil fuel-related and high emissions sectors such as transport, to climate-sensitive sectors such as agriculture and property. Very few banks indicated a quantification of the potential probability of defaults and none of the banks mentioned undertaking estimates of the potential impact to expected credit losses. The banks indicated the use of climate risk heatmaps and an asset-tagging approach to differentiate loans based on climate characteristics and emissions profile. These tools gave them the ability to monitor and benchmark the degree of balance sheet transition over time.

Some banks presented on their client engagements, advocacy and stewardship activities. These ranged from general customer awareness of climate change and direct client engagement on transition planning, to participation and representation in key industry bodies, events and working groups.

Insurers

The risk management practices varied widely between the different types of insurers. Non-life insurers, given their business models generally, presented their approach to physical climate risk assessment and management of many years. Some had developed very sophisticated natural catastrophe risk management frameworks, while others relied mostly on the expertise and experience of their reinsurers. Many insurers noted the increase in engagements on climate risks from reinsurers and that while reinsurance was still available and accessible, there were some concerns expressed on the potential future constraints and exclusions. Some insurers presented specific quantitative modelling projects to consider the potential impacts of physical risk on future underwriting strategies and on capital and reinsurance needs. These insurers indicated that the results may be used to inform future pricing and underwriting decisions. Insurers noted concerns around concentration risk in geographical areas and efforts in diversification.

Reinsurers noted that natural catastrophe risk appetite and modelling were core to what they did. Boards presented advanced modelling of natural catastrophe risk but even they indicated that further work was needed. Insurers noted that it was difficult

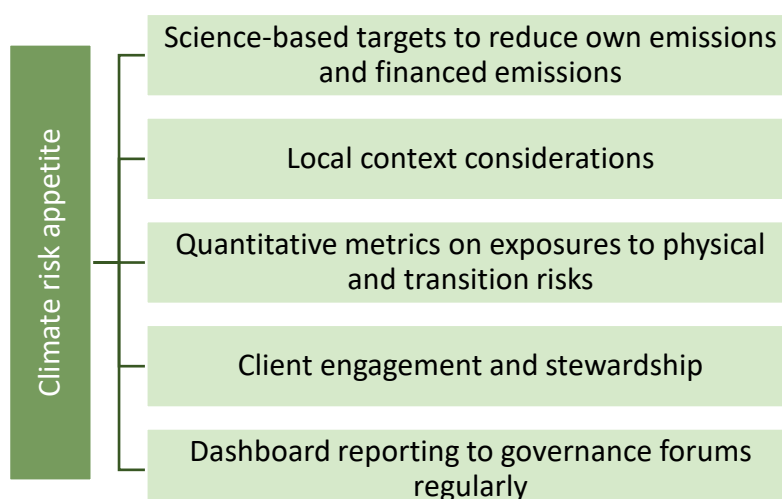
to differentiate between natural variability in climate and related natural disasters and the aggravating effects of climate change.

Life insurers reported that their focus had been on transition risks and the impact on their investment and asset management business. This included analysis on exposures to transition-sensitive sectors and developing responsible investment policies and considerations into investment mandates. Insurers specified their preference for stewardship and client engagement on transition plans and strategies rather than divestments. Most insurers indicated the importance of pursuing investments in renewable energy and low-carbon technologies and were actively seeking such opportunities in a responsible manner. Considering the impact of physical risks to mortality and morbidity was nascent, and in such cases it was considered to be immaterial.

4.2 Notable examples and considerations

The integration of climate risks into institutions' risk management frameworks should be proportionate to the nature, size and complexity of the institution. A climate risk appetite statement is intended to set the foundation and tone for the approach to climate change, include both qualitative and quantitative aspects. The approach for addressing climate risk within the risk appetite statement should align with the approach adopted for existing risk categories or cross-cutting risks. A comprehensive climate risk appetite statement indicates alignment to reducing emissions in line with science-based targets, acknowledges local context, particularly a just transition, and manages portfolio exposure to physical and transition risks, including concentration risks. The risk appetite statement is supported by enabling factors and board-level supported metrics.

Figure 2: Key considerations for developing climate risk appetite



Given the evolving nature of climate risks, transmission channels may yet be undiscovered. Banks thus need to monitor developments through various viewpoints – this goes beyond exposure to fossil fuel-related activities, to consider financed emissions to high emitting sectors and exposures to climate sensitive sectors. Some banks’ practices show that swift progress is possible.

As with other material risks, banks should develop appropriate key risk indicators for the effective management of material climate-related financial risks that align with their regular monitoring and escalation arrangements. A bank’s risk management function should provide the board and its subcommittees with reports on exposures to climate risks to enable the board to discuss, challenge and make decisions relating to the bank’s management of climate risks.

The use of climate risk heatmaps, asset tagging and a climate risk dashboard of exposure to climate vulnerable sectors, allows for varying granularity of risk measurement based on available data. Where appropriate, banks could consider risk mitigation measures such as, but not limited to, establishing internal limits for the various types of material climate-related financial risks to which they are exposed, for example in their credit, market, liquidity and operational risk profiles.

A ‘hub and spoke’ model was evident in some of the banks, whereby climate expertise was centralised in a team (the hub) working full-time on climate risks, with several

people in divisions dedicating a portion of their time to this work (the spokes). While this was not the only approach,⁹ the structure allowed for building and retaining specialist expertise and developing skills across the organisation simultaneously. A dedicated technical committee on climate data provided for increased focus, coordination and momentum in addressing data challenges.

Noting that the primary tools to mitigate and adapt to climate change were vested in government, some insurers had engaged and forged partnerships with local and provincial governments to mitigate the effects of extreme climate events such as wildfires and floods. Such partnerships included the funding of helicopters for identifying wildfires, assessments of fire services and providing municipalities with data on flood zones for urban planning. Building on catastrophe risk modelling, risk pricing, research and underwriting, the insurance industry offered a unique skillset in helping governments and other stakeholders to build financial resilience to physical risks of climate change and close the natural catastrophe protection gap.

A few insurers noted the benefits of increased engagement and collaboration with reinsurers in general and specifically on climate risk. This included the sharing of knowledge as reinsurers had wider data sources and resources, and in understanding the requirements from reinsurers, such as geolocation information, so that they could maintain their access to reinsurance at acceptable retention levels and pricing. Similarly, some reinsurers expressed a desire to share their knowledge in natural catastrophe data and modelling in the finance ecosystem and value chain.

5. Scenario analysis and stress testing

The PA requested institutions to present their approach to climate risk scenario analysis and stress testing, covering the objectives, the selected scenarios or stress events, the link with transition planning as well as their main challenges and concerns.

⁹ Other approaches include an internal network approach or creation of dedicated unit. See NGFS Guide for Supervisors for details: https://www.ngfs.net/sites/default/files/medias/documents/ngfs_guide_for_supervisors.pdf

5.1 Range of practices

Banks

Banks noted their approach to climate scenario analysis and stress testing¹⁰ was an exploratory and developing practice. The banks stated that their objectives were, as expected, to better understand the risks and to test the resilience of their strategies. Some banks mentioned how scenario analysis was being incorporated into their risk frameworks, for example, to inform exposure targets in transition-sensitive sectors. References were made to the 2021 drought scenario undertaken as part of the South African Reserve Bank (SARB) Common Scenario Stress Test (CSST) and most banks reported starting scenario and model development in earnest from 2021. Banks were developing their capabilities to assess and quantify the impact of physical and transition risks using scenario analysis and stress testing. They were preparing for the 2024 SARB macroprudential Climate Risk Stress Test (CRST). Foreign banks reported a wide range of scenario exercises undertaken and supervisory exercises in multiple jurisdictions.

All banks reported either considering or leveraging or aligning with two or three of the scenarios developed by the Network for Greening the Financial System (NGFS). These long-term scenarios considering both physical and transition risks were used to consider different potential future outcomes, acknowledging the need to make them relevant to the South African context by using domestic climate and economic models and domestic expertise. The physical risk events considered were drought, floods, wildfires, subsidence events and sinkholes.

Some banks reported a specific analysis of their property and or agricultural portfolio's sensitivities to climate risks. To consider the impact of physical risks, some banks reported developing physical risk scores and physical risk heatmaps. Few banks reported undertaking an inaugural transition risk stress test. One bank indicated work was underway to consider shorter-term scenarios.

¹⁰ For simplicity, in this feedback report stress testing is deemed a subset of scenario analysis that evaluates the effects of severe but plausible climate scenarios.

The focus had been on credit and market risk, including the estimation of probability of defaults and loss given defaults. A few banks reported incorporation into their Internal Capital Adequacy Assessment Process (ICAAPs) as an iterative, exploratory process at this stage. Some banks indicated plans to include operational risk. The scenario analysis and stress testing exercises were limited to domestic operations and those branches with African operations had plans to extend these exercises across the region in the future. Foreign branches reported a wider development and use of scenario analysis and stress testing, albeit not specific to South Africa, including, for example, a governance and review team, an abrupt transition risk scenario and acute physical risk scenario.

With regard to transition planning, the banks reported at a high level their initial work around transition pathways. This was nascent and discussed with some level of hesitation, given policy uncertainties as well as data quality and availability challenges. Challenges beyond data availability and quality that banks presented included expertise and skills to perform scenario analysis and climate risk modelling. The long-term scenarios could be challenging to interpret for bank-specific impacts and the lack of industry guidance and standardised methodologies to assess the financial impact of climate change. The unique and complex characteristics of climate risks – lack of historical precedent, interconnectedness, high degree of uncertainty and potentially longer time horizon – made risk management in general and scenario analysis in particular challenging. Where scenario exercises were undertaken, the results were presented and used with caution given the challenges.

Insurers

Insurers reported various stages of maturity with regard to stress testing and scenario analysis frameworks for climate risks. Generally, given the business model of non-life insurers and reinsurers, stress testing and scenario analysis for physical risks were reported as more advanced than those for transition risks. However, insurers noted that even these matured methodologies and scenarios did not necessarily consider the potential effects of future developments of climate change and were mostly confined to shorter time frames with the purpose of informing short- to medium-term business planning, underwriting (pricing and reserving) and risk management decisions. Similarly to the banks, insurers reported leveraging the scenarios

developed by the NGFS, most notably the scenarios entitled an orderly transition, a disorderly transition and a hot house world. Life insurers reported a focus on transition risk as they considered the potential impact on long-term investment decisions.

With regard to physical risk scenarios, insurers reported their ongoing work on natural catastrophe risks, including floods, wildfires and hailstorm events. Insurers presented heatmaps and/or hazard maps used to identify concentrated and vulnerable exposures. Insurers indicated these were used to inform pricing and underwriting decisions for different types of insurance and reinsurance policies. With regard to transition risk scenario analysis, insurers reported identifying and managing concentrated exposures to transition sensitive sectors. Such analysis would be used to inform their own investment portfolios as well as their own operations and supply chains.

In discussion, a few insurers have begun to consider how to quantify and address climate litigation risks. Insurers noted that litigation risk was highly complex and scenarios were still nascent given the policy uncertainties and variety of disclosure frameworks and requirements. One institution presented their climate litigation scenario exercise which provided insights into possible litigation risk exposures and prompted further internal discussions.

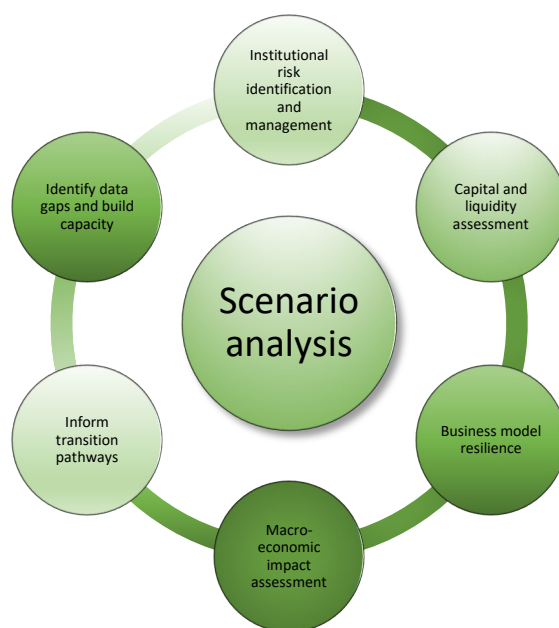
Similarly to the banks, the insurers raised challenges with capacity (skills and resources); uncertainties in regulatory requirements and data limitations (quality, reliability and availability); and a lack of guidance around methodologies and scenarios.

5.2 Notable examples and considerations

Banks and insurers were at various stages of developing scenarios and undertaking climate stress tests as a tool to quantify the impacts of climate risks. All institutions indicated further progress was necessary. Data challenges were pervasive. The BCBS newsletter on the implementation of the Principles for the effective management and

supervision of climate-related financial risks¹¹ noted that supervisory climate scenario exercises had been a catalyst for building banks' resources and capability and had helped to identify data and methodological gaps. In addition, significant human resources, expertise and time were required to improve data availability and quality through investment in better tools and greater automation to capture climate data and minimise operational risks associated with manual processes. Scenario analysis exercises may be used for various objectives, such as those depicted in Figure 3.

Figure 3: Examples of various objectives of climate scenario analysis



The 2024 SARB macroprudential CRST is exploratory in nature and the SARB expects to reveal the most significant, system-wide outcomes of the banking industry's resilience to climate change, together with aggregated results, if applicable. The outcomes from the exercise will inform future macroprudential tests and be used as an input for future supervisory guidance. Although the SARB Financial Stability Department is neither a regulator nor supervisor, the PA is a member of the SARB Financial Stability Committee and the outcomes of this exercise could be used to guide supervisory efforts relating to climate risk.

¹¹ See Basel Committee newsletter: https://www.bis.org/publ/bcbs_n133.htm

Both quantitative and qualitative aspects of climate scenario analysis are important. Foreign banks reported that the key benefit at this point was the process rather than the results. The process allows for engagement across divisions and the building of skills and identifying data gaps. The discussion of the results informed their thinking around the long-term impacts of the transition to a low carbon economy and helped them to identify and initiate client engagement on transition planning.

6. Disclosures and reporting

Lastly, boards were requested to present on their respective institution's internal reporting and disclosures of climate risks. The presentations covered a high-level summary of the types of information disclosed and main challenges, without going into the details of each report.

6.1 Range of practices

Banks

Internal reporting on climate risks to the board ranged from as required and quarterly to every board meeting. The purpose and content of the reporting mirrored the governance frameworks described earlier in this report. Most banks reported using existing escalation channels. Examples were provided of qualitative and quantitative metrics and dashboards of progress against targets.

All banks reported using the TCFD framework for public disclosures, noting that the TCFD framework had recently been incorporated in the ISSB's climate-related disclosure standard S2. Banks reported using other frameworks as well and expressed the need to keep vigilant of international developments and the plethora of standards and frameworks being developed. Boards were cognisant of greenwashing, reputational risks and climate-litigation risks. Litigation threats were discussed from both aspects – threats of disclosing too much information at the risk of revising targets in the future due to changes in data sources or incorrect data; and threats from disclosing too little information. Boards raised reliability and integrity concerns with disclosing proxy or third-party data sources, particularly when disclosing targets. Data

challenges were pervasive and discussed as acute with regard to data from government or state-owned enterprises. Standardisation of metrics for reporting and the need for assurance were raised.

Insurers

Insurers have developed a range of internal and external reporting and disclosure practices. The objectives ranged from adhering to regulatory requirements and stakeholder engagement to informing strategy and business planning processes.

Most insurers had started to report on climate risks internally although there were variabilities in the scope and detail. Reporting was often used to provide information to the social and ethics committees and/or the risk and compliance committees to inform strategic and business planning decisions but also at an operational level to inform risk management, underwriting and pricing decisions.

Most insurers had been disclosing climate-related information for several years and the information was increasingly becoming more comprehensive and refined. Insurers reported using the TCFD recommendations initially and providing predominantly qualitative information. Some had begun to include more quantitative information (although still limited) in alignment with the ISSB standards. Some insurers also followed other noteworthy reporting frameworks such as the Carbon Disclosure Project (CDP) and the Global Reporting Initiative (GRI).

The format of the disclosures ranged from stand-alone sustainability (or ESG) reports, dedicated climate risk reports and/or integration into existing reports such as insurers' annual reports.

Insurers reported challenges around capacity and expertise, data (quality, availability and cost), inconsistent methodologies used to determine certain quantitative metrics as well as inconsistent design, the implementation of scenario analysis and making significant assumptions over long time frames. These challenges together with the overwhelming amount of information, regulations (locally and internationally), guidance and standards are a concern for most insurers.

6.2 Notable examples and considerations

Institutions' disclosure of climate risks reflected their progress made in the preceding areas of this report (governance, strategy, etc). Thus, as institutions advanced their understanding, management and mitigation of climate risks, the granularity of their disclosures would evolve. The accuracy, consistency and quality of climate-related data were still evolving, but at the same time, disclosure requirements would accelerate the availability of such information and facilitate forward-looking risk assessments by banks.¹² Some banks expressed their plans to develop in-house data capabilities over the short, medium and longer term. These plans required effective governance systems to oversee developments and ensure the appropriate integration of third-party data sources. Where assumptions and proxies were used as an interim measure, these should be internally documented and disclosed.

Board members aware of international practices, particularly in the European Union (EU) and United Kingdom (UK), were cognisant of the shift from voluntary to regulatory reporting requirements and recognised the implication of global development in regulations and standards. The BCBS was currently seeking views on whether the introduction of a Pillar 3 framework would help to promote comparability of banks' risk profiles and enable market participants to access key information relating to a bank's risk exposures in relation to climate-related financial risks.¹³

7. Next steps

The 2023 flavour-of-the-year discussions provided the PA with an overview of the work underway in selected institutions in embedding an understanding of climate risks. The information will help inform the PA's development of appropriate climate risk guidance and ongoing supervision of institutions.

The PA continues to engage, coordinate and collaborate with the Financial Sector Conduct Authority (FSCA) to develop a coordinated and complimentary financial

^{12,13} See BCBS public consultation paper on a Pillar 3 disclosure framework for climate-related financial risks. <https://www.bis.org/bcbs/publ/d560.htm>

sector regulatory and supervisory approach to climate risks within a broader sustainable finance agenda.

Abbreviations

BCBS	Basel Committee on Banking Supervision
CDP	Carbon Disclosure Project
CRST	Climate Risk Stress Test
CSST	Common Scenario Stress Test
ESG	environmental, social and governance
EU	European Union
FOTY	flavour of the year
FSCA	Financial Sector Conduct Authority
GHG	greenhouse gas
GN	guidance note
GRI	Global Reporting Initiative
IAIS	International Association of Insurance Supervisors
ICAAP	Internal Capital Adequacy Assessment Process
ISSB	International Sustainability Standards Board
NGFS	Network for Greening the Financial System
PA	Prudential Authority
PACTT	PA Climate Task Team
SARB	South African Reserve Bank
SDG	sustainable development goal
TCFD	Task Force on Climate-related Financial Disclosures
UK	United Kingdom