LCP's response to the PRA's consultation on 'Enhancing banks' and insurers' approaches to managing climate-related risks – Update to SS3/19'

Issued on 30 July 2025

This document sets out LCP's response to the PRA's draft supervisory statement and the accompanying consultation paper CP10/25 published on 30 April 2025.

Who we are

LCP is a firm of financial, actuarial, and business consultants, specialising in pensions, investment, insurance, energy, health and business analytics. We have over 1,100 people in the UK, including over 190 partners and around 275 qualified actuaries. The provision of actuarial, investment, covenant, governance, pensions administration and benefits advice, and directly related services, is our core business. About 90% of our work is advising trustees and employers on all aspects of their pension arrangements, including investment strategy. The remaining 10% relates to insurance consulting, energy and health analytics.

Insurance specific business lines: LCP advises:

- pension schemes on the selection of bulk annuity insurance providers; and
- a broad range of general insurers across the UK market of varying sizes and business models.

For the former, financial soundness of the insurers is a key consideration, including their approach to managing climate-related financial risks. LCP is a market leader when it comes to advising on UK bulk annuity transactions, ie where a pension scheme secures its liabilities by purchasing annuities from an insurance company. We have been lead adviser on 300+ insurance transactions since 2014, more than any other consultant in the market. These deals have transferred over £85bn of assets to insurers.

In relation to the latter, our work spans risk, reserving, capital modelling, Solvency II/UK and data analytics. We have provided independent review of general insurance reserves totalling more than £100bn in recent years and have supported over 80 insurers with capital modelling and validation.

Our comments on your proposals

From our comments below, you will see that we are broadly supportive of the changes you are proposing. Our key recommendations are as follows:

- Greater focus on actions that reduce real-world climate risks, through reducing greenhouse gas (GHG) emissions and adapting to climate change
- Clearer guidance on proportionality to reflect firm size, business model and time horizons
- More practical support to incorporate tipping points and second order effects in climate scenario analysis
- Greater recognition of current data and modelling limitations, whilst encouraging use of forward-looking tools and metrics
- Clear communication by the PRA, through appropriate channels, that greater climate action is needed by governments and others (in addition to the PRA and insurers) to manage climate-related risks to the insurance system.

We are happy for LCP to be named as a respondent to the consultation and for our response to be in the public domain. We are happy for you to reference our comments in any response.

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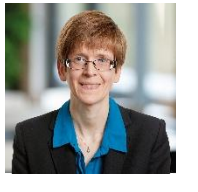

1. Introduction and background

We support the PRA's continued leadership in advancing climate-related financial regulation and recognise the importance of evolving supervisory expectations in response to the growing urgency of climate-related risks.

We welcome CP10/25 as a significant step forward from SS3/19. The proposed updates reflect the increasing maturity of climate risk management practices and align well with international developments.

In this response, we offer constructive feedback on the proposals, drawing on our wide experience of advising insurers and assessing bulk annuity providers, and our understanding of the differing operational challenges and opportunities they face. We focus on the supervisory expectations for insurers, rather than banks, given that the former is our area of expertise.

We aim to support the PRA in refining its expectations to ensure they are ambitious yet proportionate, and to help firms embed climate-related considerations in a way that is meaningful, strategic and aligned with their business models.

It is important that the supervisory expectations are not unduly onerous: the PRA should ensure the benefits of adopting the climate risk management practices envisaged are expected to outweigh the costs. This cost-benefit analysis should take into account the longer-term benefits to the insurance (and banking) system as a whole, not just the immediate benefits to individual firms. In particular, we note that the short-term costs of reducing GHG emissions are expected to be outweighed by the reduction in long-term economic damage from climate change. We have made a number of recommendations which are aimed at mitigating the costs for firms in complying with the expectations and making sure they are applied proportionately.

2. Particular issues for bulk annuity provision

LCP is concerned that climate change poses a material systemic risk to the financial system and that insufficient action is currently being taken by financial actors to address this risk. We believe there is a real risk that climate change will destabilise financial markets within the coming decades, potentially leading – in more extreme cases – to the insolvency of multiple UK bulk annuity providers. This is due to the severity of physical climate impacts in higher warming scenarios[1], the large gap between the reductions in GHG emissions planned and needed[2], and emerging evidence that suggests higher-than-expected climate sensitivity to atmospheric GHG concentrations[3].

As adviser to many defined benefit pension schemes (and their sponsoring companies) on the transfer of their liabilities to insurance companies, we are keen to see policies and regulation that increase the likelihood that these insurers will be able to pay members' pensions in full, noting that the liabilities extend many decades into the future. This issue is particularly important given the significant transfers that are taking place – UK insurers' annuity portfolios held approximately £375bn of assets at the end of 2024[4] and we project that a further £400bn-£600bn will be transferred over the next decade – meaning that millions more people will be relying on the UK insurance industry for their retirement income.

3. Role of UK solvency regime

For the avoidance of doubt, we do not consider it appropriate or realistic to aim for a solvency regime that minimises insolvency risks even in the most severe warming scenarios. We believe it is important that the PRA and others acknowledge publicly this limitation of the insurance solvency regime and the limits on the ability of insurers (individually and collectively) to mitigate climate risks.

The PRA has responsibility for protecting policyholders, but it cannot do that alone. In relation to climate change, more urgent and more ambitious action is needed across the global economy to reduce the likelihood of higher warming scenarios. In particular, governments need to go further in implementing policies that are consistent with a rapid transition to net zero GHG emissions. We encourage the PRA to highlight the need for climate action by governments and other parties so that it can continue to meet its statutory objectives.

[1] Sixth Assessment Report — IPCC
[2] Emissions Gap Report 2024 | UNEP - UN Environment Programme
[3] Climate Scorpion – the sting is in the tail
[4] Data collected from LCP surveying UK bulk annuity insurers

In addition, the PRA's supervisory regime has an important role to play in encouraging more urgent and more ambitious climate action by the UK insurance industry.

4. Implementation

We support the PRA's ambition to raise standards in climate risk management across the financial sector. However, we note that the proposed expectations may be perceived by some insurers – particularly smaller firms or those with less direct exposure to climate-related risks – as operationally challenging. This is especially true in areas such as scenario analysis and in governance, where expectations may be interpreted as requiring significant structural changes.

To ensure the effectiveness and practicality of implementation, we recommend the following:

- **Clearer guidance on proportionality**: While the draft SS describes proportionality, we believe further clarification would be helpful. This could include illustrative examples of how expectations might be met by firms of different sizes and business models, particularly distinguishing between the general insurance sector and annuity providers where climate exposures and time horizons differ significantly.
- **Alignment with other frameworks**: To reduce duplication and support consistency, we suggest the PRA clarifies how its expectations align with other regulatory initiatives, including the TCFD and CSRD (Corporate Sustainability Reporting Directive) standards. This is particularly important for firms that are subject to multiple reporting requirements.
- **Narrative scenarios**: We are pleased to see the inclusion of narrative climate scenarios, which play an important role given the limitations of quantitative models. We recommend avoiding language that refers to these as "less sophisticated" (for example in paragraphs 3.11 and 4.3.11), as this may discourage their use.
- **Innovation and opportunity**: We encourage the PRA to give greater recognition to the opportunities for innovation in underwriting and investment that the climate transition presents. This includes the development of new products, services and investment strategies that support decarbonisation and resilience.

5. Review of proposed updates by SS chapter

Before turning to our chapter-by-chapter comments, we would like to raise a broader point on the framing of climate-related risks.

We suggest that the PRA sets an explicit expectation that firms should consider how climate-related risks interact with other emerging risk areas, particularly nature-related and social risks. For example, deforestation can amplify physical climate risks, and social impacts may influence transition pathways.

Chapter 1: Governance

We support the PRA's efforts to strengthen governance expectations for climate-related risks. We welcome the emphasis on board-level ownership, strategic alignment and integration into risk appetite frameworks.

We offer the following observations and recommendations:

- **Board ownership and flexibility**: We agree that boards should take ownership of climate risk appetite and ensure alignment with internal strategy. We recommend the PRA continues to allow flexibility in how firms structure governance, recognising that different models may be appropriate depending on the firm's size, complexity and business mix.
- **Time horizons:** We suggest that duration of policies (insurers) or loans (banks) is included explicitly as an extra bullet in paragraph 4.1.3.
- **Third-party arrangements**: We note the expectations in paragraph 4.1.16 regarding third-party arrangements. We suggest these could be expanded to include setting clear climate-related expectations for third parties, monitoring performance against these expectations, and taking action where necessary. We recommend that any additional expectations be framed proportionately (eg focused on key providers), particularly for firms with extensive outsourcing networks or limited influence over third parties. Key providers may include external fund managers and reinsurers where exposures can be material, especially for annuity businesses.
- **Role descriptions and performance management**: We are pleased that paragraph 4.1.14 envisages an appropriately senior person being allocated individual responsibility for identifying and managing climate-related risks, which is reflected in their role description, performance expectations and remuneration. We support this, but suggest that the PRA goes further by expecting inclusion of climate-related responsibilities in role descriptions,

performance expectations and the reward system for a wider group of people who play key roles in effective climate risk management.

- **Learning and development**: We propose that relevant staff/board members should have access to learning and development opportunities on an ongoing basis to build and maintain an understanding of climate change appropriate to their role. We suggest a principles-based approach to allow firms to tailor content and delivery methods to their specific risk profile and workforce. As an example, the principles could include an expectation that learning and development opportunities are provided to all relevant staff so that they have an up-to-date understanding of climate change which is appropriate for their role.

Chapter 2: Risk Management

We support the PRA's proposals to strengthen the integration of climate-related risks into insurers' risk management frameworks.

Key points from our perspective include:

- **Relationship-level risk assessments:** The expectation for consistent assessments across clients, counterparties, investees and policyholders is ambitious. While this is a logical extension of good risk management, the data requirements, particularly for SMEs and retail policyholders, are significant. Firms will need time to build engagement strategies and data partnerships.
- **Operational resilience:** The integration of climate risk into operational resilience frameworks is a positive step. However, firms would benefit from clearer expectations on how to assess third-party and supply chain vulnerabilities, particularly where those parties are outside the PRA's regulatory perimeter.
- **Use of forward-looking tools**: We support the expectation that firms should move beyond reliance on historical data. We recommend the following:
    - We suggest strengthening paragraph 4.2.4 by removing the word "consider", while also maintaining some flexibility in the wording to reflect the varying maturity of firms' modelling capabilities and the varying availability and robustness of data.
    - We recommend referencing forward-looking metrics, in addition to scenario analysis and stress testing, in 4.2.4. We believe it is important not to focus narrowly on backwards-looking emissions metrics as these provide a limited and potentially misleading view of risk exposure and may discourage firms from investing in high-emitting companies with credible plans to transition.
- **Current limitations of quantitative approaches:** We support paragraph 4.2.19 which acknowledges that there are areas where data, models or risk measurement tools are not yet adequate to measure risks accurately or to calculate reliable metrics. We suggest that this paragraph is cross-referenced from other paragraphs which encourage the use of quantitative methods (eg paragraph 4.2.13).

Chapter 3: Climate Scenario Analysis

We support the PRA's emphasis on climate scenario analysis (CSA) as a key tool for understanding climate-related risks, including referencing tipping points and second-order impacts. However, we believe that these should be given more emphasis, while noting that incorporating them in CSA may present practical challenges for some insurers. We offer the following recommendations:

- **Tipping points:** We note the PRA's recognition that many firms are not yet considering tipping points. To help with the incorporation and understanding of tipping points, we recommend that the PRA provides references to emerging good practice and some tangible examples of how firms can allow for these within CSA.
- **Second-order impacts:** We note that second-order impacts, such as macroeconomic effects, supply chain disruptions, and societal responses, can be more material than direct physical or transition risks. We encourage the PRA to comment on this within the SS. To help with the incorporation and understanding of second-order impacts, we recommend that the PRA provides references to emerging good practice and some tangible examples of how firms can allow for these within CSA.

We suggest that liability risk (eg the risk from past underwriting activity) is explicitly mentioned within the scenario analysis section, eg include it within paragraph 4.3.15.

Chapter 4: Data

We support the PRA's emphasis on improving climate-related data capabilities and agree that data and model uncertainty are central challenges in managing climate risk. Collecting data from clients and counterparties is important but challenging. Industry-wide templates or collaborative initiatives could ease the burden and improve data quality.

Chapter 5: Disclosures

We support the PRA's disclosure expectations.

We recommend the following:

- **Framework alignment:** We encourage the PRA to clarify how its disclosure expectations align with other regulatory initiatives such as the proposed UK Sustainability Reporting Standards (SRS), to support consistency and reduce operational burden.
- **Sufficient granularity:** We would like disclosures to enable readers to understand the differences in climate-related risk exposures, impacts and approaches between different parts of firms' businesses, where these are significant. When complex firms provide aggregate disclosures only, it is difficult to compare them in a fair way. Better disclosure at a business unit level, in a consistent manner, would make it easier for shareholders and customers to hold firms to account and could help to drive better practices across the industry. Where a firm discloses examples of its climate-related practices, for example investments made or stewardship undertaken, it should ensure it is clear which parts of its business the examples relate to.

Chapter 6: Banking-specific issues

As this chapter relates specifically to banking institutions, we do not offer comments on this section.

Chapter 7: Insurance-specific considerations

We welcome the PRA's proposals to clarify how climate-related risks should be integrated into insurers' risk management frameworks, Own Risk and Solvency Assessments (ORSAs), Solvency Capital Requirements (SCRs), and regulatory balance sheets.

- **Liability risks:** We recommend that liability risk is identified as a primary channel that climate change risk can arise through, eg in section 2.1. Separating out liability risk will highlight that many firms may have accumulated material exposures to climate risk from past underwriting activities and ensure it has the focus it requires given the potential size.
- **Climate-related risks in the SCR:** We support the clarification that climate-related risks should be considered within the existing SCR framework and welcome the confirmation that no new capital requirements are being introduced.

6. Reducing firms' contributions to real-world climate risks

The focus of the SS is, understandably, on managing the direct risks to banks and insurers from climate-related factors. However, the actions of banks and insurers have real-world impacts that may exacerbate, or help to mitigate, the risks that the sector faces in future from climate change.

Given the financial stability risks from climate change outlined above, and the PRA's role in relation to protecting financial stability, we believe it would be appropriate for the SS to encourage actions by insurers that help to:

- reduce real-world GHG emissions and accelerate the net zero transition; and/or
- build resilience and adapt to the effects of climate change.

For example, we recommend the SS incorporates the following points:

- **Climate transition plans:** In addition to saying (in paragraph 4.1.6) that plans to meet any climate-related targets should be integrated into business strategy, the SS should set an expectation that the plans are credible. In relation to emissions reduction targets, this means that firms should be able to explain:
  - How far and how fast the firm expects to be able to reduce its GHG emissions (including its financed and/or underwritten emissions), in the form of short, medium and long-term targets;
  - A set of planned actions that are consistent with meeting (at least) the short-term targets;
  - An analysis of the gap between the firm's targeted emissions reduction pathway and a 1.5°C pathway, and the actions needed by others (eg governments, customers) to close the gap.
- **Stewardship:** Insurers should be encouraged to undertake stewardship that encourages and supports climate adaptation and the net zero transition. For example, we suggest expanding paragraphs 4.5.4 and 4.5.5 – which relate to stewardship to encourage improvements in climate-related risk disclosures –

to also encourage real-world actions that mitigate climate risks. In addition, the PRA could – through its dialogue and educational materials – play an important role in improving the standard of stewardship outside listed equity, including greater focus on engagement with relevant parties other than investee companies (eg policymakers, industry bodies, service providers).

- **Collaboration:** The SS should highlight that collaboration between insurers, and with other investors, can be an important and effective way of driving real-world change that helps to reduce climate-related risks.
- **Investment in transition-enabling assets**: We would like to see insurers encouraged to invest in assets that enable emissions reductions elsewhere in the economy, provided such investments are consistent with investment objectives, risk appetite, regulatory constraints, and fiduciary duties.

7. Conclusion

We commend the PRA for its continued leadership in advancing the integration of climate-related risks into the UK insurance sector's governance, strategy and risk management practices. The proposals represent a significant and timely evolution of SS3/19, reflecting the growing urgency of climate change and the increasing maturity of firms' approaches.

In this response, we have offered constructive feedback and recommendations aimed at ensuring the PRA's expectations are:

- **Ambitious yet proportionate**, recognising the diversity of business models and risk profiles.
- **Clear and practical**, supporting firms in embedding climate considerations in a meaningful and strategic way.
- **Aligned with other frameworks**, to reduce duplication and promote consistency across regulatory and market initiatives.
- **Supportive of innovation and opportunity**, enabling insurers and annuity providers to play a positive role in the transition to a net zero economy.

We also encourage the PRA to continue facilitating industry collaboration on climate data and modelling approaches, sharing good practice, and supporting the development of tools and guidance that can help firms meet evolving expectations.

We would welcome the opportunity to engage further with the PRA on these issues and to support the development of practical, proportionate and forward-looking supervisory approaches to climate-related financial risks.