



20 December 2021

To: Board of Directors of All Category 'A' and 'B' Banks

Supervisory Issues and Information Circular

Re: Impact of Climate Change on the Banking Sector

Introduction

The Cayman Islands Monetary Authority ("CIMA") recognises that financial institutions, including banks, are exposed to climate-related financial risks regardless of their size, complexity or business models. As per a recent Basel Committee on Banking Supervision ("BCBS") report¹, the banks and the banking system are exposed to climate risk through macro-and microeconomic transmission channels that arise from physical climate risk drivers and transition risk drivers.

Physical risks arise from economic costs and financial losses resulting from the increasing severity and frequency of physical climate risks such as severe weather and long-term shifts in climate. Transition risks can arise from the process of adjustment towards a low-carbon economy. A range of factors influences this adjustment, including climate-related developments in policy and regulation, the emergence of disruptive technology or business models and shifting sentiment or societal preferences.

CIMA also recognises that climate-related risks could affect the safety and soundness of individual banking institutions and have broader financial stability implications for the banking system. Although climate-related financial risk is a complex and developing subject, there is a growing need for the licensees to integrate climate-related risks into their business strategies and processes. As such, all licensees should design a plan to incorporate climate-related risks into their business activities and better understand the impact of climate-related risks. At a minimum, all licensees should plan to integrate climate-related risks in the areas outlined below.

Business strategy and governance

Each licensee's governing body should initiate measures to understand, assess and incorporate the financial risks from climate change within the licensee's overall business strategy and risk appetite. Licensees are encouraged to revise their risk appetite statement to include the risk exposure limits and thresholds for the financial risks that the licensee is willing to bear. The governing body should aim to document how the licensee monitors and manages the financial risks from climate change in line with its risk appetite statement. Additionally, the governing body should ensure that there are clear roles and responsibilities for the governing body, its relevant sub-committees and senior management in managing the financial risks from climate change.

¹ See BCBS report on Climate-related risk drivers and their transmission channels, April 2021

Risk management

Licensees should take necessary steps to integrate climate risk into the existing risk management framework in line with the licensee's risk appetite. Licensees should implement measures to carry out a comprehensive assessment of climate-related financial risks and set clear definitions and thresholds for materiality, and start establishing reliable approaches for identifying, measuring, monitoring and managing material climate-related risks.

Supervisory review process (Pillar 2)

Licensees required to submit Internal Capital Adequacy Assessment Process ("ICAAP") reports to CIMA, must incorporate climate-related risks in their respective ICAAP reports commencing with the ICAAP reports for 2021. At a minimum, the ICAAP reports should include the planned responses (or measures already implemented, if applicable) to incorporate climate-related risks into the following areas: business strategy, risk appetite, corporate governance, internal controls, integration into the risk management framework, risk identification and measurement, materiality assessment, monitoring and reporting, among others.

The expectations and practices around climate risk are quickly developing and evolving. CIMA will continue to undertake further reviews, including assessing the available information such as international best practices, to develop a suitable regulatory and supervisory approach for climate-related risks.

Should you have any questions, please email the Banking Supervision Division at contactbanking@cima.ky.