

Guidance 3b: Best practices for developing a risk appetite statement (RAS)

Recommended sections in a risk appetite statement

1. Purpose and scope

Establish why the (climate) risk appetite is set and to whom/what it applies

2. Integration with strategy and governance framework

Embed (climate) risk appetite within enterprise risk management, supporting business, strategy and compliance needs

3. Risk appetite statement

Articulate the institution's tolerance for climate-related risks and the overarching approach to opportunities

4. Limits, thresholds and monitoring

In practice, most institutions add 3-8 climate-specific indicators (or thresholds) spread across risk types in risk appetite documents. Track adherence to risk appetite through ongoing monitoring and structured reporting

Core principles for RAS:

- Specify appetite at a granular level
- Explicit time horizons recommended

Example of typical language in climate-related RAS:

- Low appetite for climate risks threatening financial stability or organisational reputation
- Moderate appetite for supporting the net zero transition
- Moderate appetite for exposures to high-emitting sectors
- High appetite to support clients in climate adaptation

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Recommended (non-exhaustive) list of metrics for climate-related RAS:

- % of portfolio with high physical/transition risk exposure
- Level of alignment of overall portfolio to Paris goals (*i.e. sectoral emissions pathways in line to keep global temperature increase well below 2°C*)
- Financed emissions breakdown (*Scopes 1, 2 of clients; Scope 3 if relevant*)
- % of clients who have been engaged on developing credible transition plans
- Sectoral/geographic risk concentrations

1. Long term scenario analysis to project existing metrics

Use scenario analysis to understand the projection of metrics that are used to measure and monitor risk appetite under set scenarios. The projected metrics can guide pre-emptive actions.

Metric	Appetite	Tolerance	Current RAG	Scenario 1 – 2050	Scenario 2 – 2050	Scenario 3 – 2050
	X%	Y%	Z%	A%	B%	C%

2. Defining new metrics and thresholds under a specific scenario

The scenario analysis could identify that new, additional, metrics with defined appetite and tolerance may need to be added under a specific scenario.

Metric	Appetite	Tolerance	RAG
	X%	Y%	Z%
XXXX under disorderly 2 degrees scenario	D%	E%	F%

3. Using metrics which incorporate longer term view

For climate risk, metrics may need to be altered to incorporate the longer term risks. For example, a transition risk rating which incorporates the customer's expected credit risk under longer term scenarios may need to be defined.

Metric	Appetite	Tolerance	RAG
% High Transition Risk Ratings in portfolio	X%	Y%	Z%
QoQ leverage of high transition risk industries/ customers	X%	Y%	Z%

See Module 13 on scenario analysis.

Risk tolerance can be quantified (e.g. % of portfolio/segment, maximum loss per quarter etc)

or...

FIs can use more qualitative Red-Amber-Green (RAG) systems to flag risk limits.

Example of risk limits in RAS

Source: CFRF