



**TOPICS:**  
STRESS TEST, CLIMATE RISK

**SOURCE:**  
 European Central Bank

## ECB: Climate Risk Stress Test

### Climate Risk Stress Test (CST)

- The **ECB will be conducting** a stress test on climate-related risks, to be called the 2022 ECB **Climate Risk Stress Test (CST)**, and will be run **from March to July 2022**. The ECB aims **to identify vulnerabilities, industry best practices and the challenges faced by banks**. The exercise will also help enhance **data availability and quality**, and allow supervisors to better understand the stress-testing frameworks banks use to gauge climate risk. **The output of the stress test exercise will be integrated into the Supervisory Review and Evaluation Process (SREP)** using a qualitative approach. No direct capital impact via the Pillar 2 Guidance is envisaged. A possible impact of the exercise will be indirect, via the SREP scores on Pillar 2 requirements: ultimately ECB will know which banks have performed well or poorly and so the stress test process is therefore being used as a catalyst for banks to strengthen their risk modelling, data quality etc.

### Three Main Distinct Modules and Two Key Steps

- **Module 1 – An overarching questionnaire** to assess how banks are building their climate stress test capabilities for use as a risk management tool. The questionnaire includes 78 questions divided into the categories: climate risk stress test governance and risk appetite, integration of climate risk stress test into institution's strategy, stress test methodology, stress test scenarios, Data, ICAAP, future plans regarding climate stress testing and interaction with other priorities, internal audit function and climate stress test, application of parent company climate risk stress test framework, institution's assumptions for bottom-up climate risk stress test and metrics (vulnerabilities in a disorderly transition, transition risk strategy, drought and heat risk and flood risk). Module 1 will provide an overview of where banks are in this process.
- **Module 2 – A peer benchmark analysis** to compare banks across a common set of climate risk metrics, including how much banks rely on income from carbon-intensive industries (interest, fee and commission income from greenhouse gas intensive industries) and what volume of greenhouse gas emissions banks finance. Banks are asked to split their corporate exposures between 22 industries using NACE codes. Module 2 will provide an indicative proxy for the sustainability of banks' business models and how exposed banks are to emission-intensive companies.
- **Module 3 – A bottom-up stress test** targeting transition and physical risks. The stress test assesses how extreme weather events would affect banks over the next year, how vulnerable banks are to a sharp increase in the price of carbon emissions over the next three years and how banks would respond to transition scenarios over the next 30 years. The stress test considers the impact of transition risk based on credit risk. Banks will provide starting points and their own projections under a common scenario and methodology prepared by the ECB. Supervisors will then challenge banks' starting points and projections. The module allocation respects the proportionality principle, so that smaller banks in the sample are not required to develop their own projections under Module 3 and are subject to a less complex quality assurance; the allocation also considers exceptional circumstances such as on-going restructuring processes.
- The exercise consists of **two key steps**. First, all participating banks are asked to provide starting point values for credit and market risk. Second, banks subject to Module 3 are asked to make projections for these two types of risk. All significant institutions participating in the 2022 climate risk stress test exercise are subject to Modules 1 and 2. The scenarios of the 2022 CST will be based on the ECB economy-wide climate stress test of 2021.
- **The ECB will conduct the CST 2022 in tandem with other ECB supervisory initiatives on climate-related and environmental risk in 2022**. Specifically, the ECB will carry out a Thematic Review of banks' climate-related and environmental risk management practices and will fully include the results in the SREP.

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