EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Climate Risk Stress Test 2022

Final Results

8 July 2022

Frank Elderson, Vice-Chair of the ECB Supervisory Board

The 2022 climate risk stress test

Objectives

- Optimise **banks and supervisors' capacity to assess climate risk**
- Enhance the **available information** on climate risk stress testing

Timeline

January – July 2022

Scope & methodology

- **Module 1**: Qualitative assessment of climate risk stress test framework
- **Module 2**: Stock-take on (i) sustainability of banks' income and (ii) financed GHG emissions
- **Module 3**: Bottom-up stress test

Scenarios

Transition risks based on NGFS scenarios:

- Short-term risk of a frontloaded rise in carbon price (3 years)
- Long-term transition paths under different scenarios (30 years)

Physical risks for Europe:

- Flood risk (1 year)
- Drought & heat risk (1 year)

Sample

- **104 Banks** (not all banks subject to the same requirements)

Main findings: 2022 Climate risk stress test

Overall performance

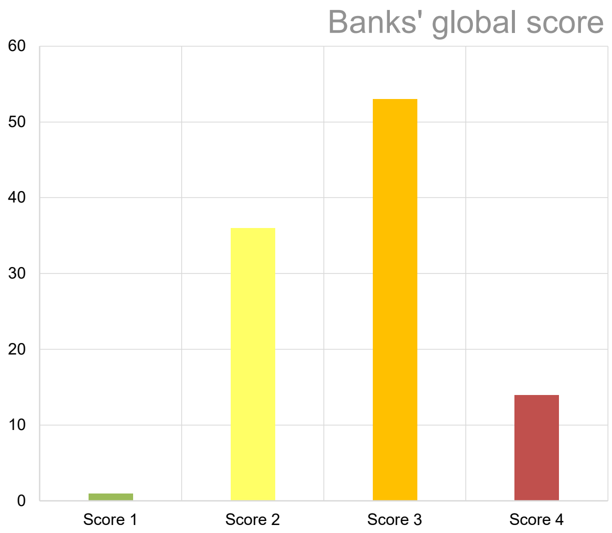
Banks **managed to submit** a large set of innovative qualitative and quantitative information.

Around 65% of the banks scored ''poorly'' and showed **significant limitations** in their stress test capabilities.

A large share of banks don't conduct an **in depth climate risk stress test as part of their Internal Capital Adequacy Assessment Process (ICAAPs)**.

Most banks need to work further on improving their:

- Stress test frameworks' governance structure
- Data availability
- Modelling techniques



*Scoring grade from 1 (best) to 4 (worst score), combining qualitative and quantitative assessments of banks' submissions.

Main findings: 2022 Climate risk stress test

MODULE 1

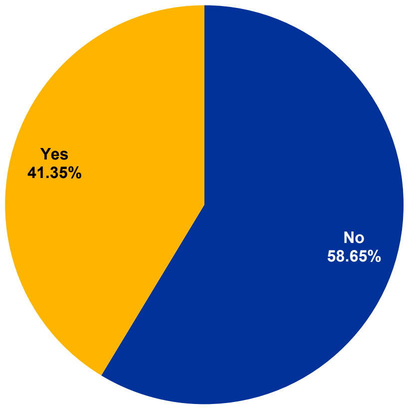
Around 60% of banks do not have a **climate risk stress testing framework**.

Climate risk coverage (e.g. transition and/or physical risks) requires further enhancements

Most banks have not yet included climate risk in their credit risk models. Just 20% consider climate risk as a variable when granting loans.

A large share of banks do not use climate risk stress test outcomes to inform their **business strategy.**

Is climate risk currently included in the institution's stress test framework? (%)



Main findings: 2022 Climate risk stress test

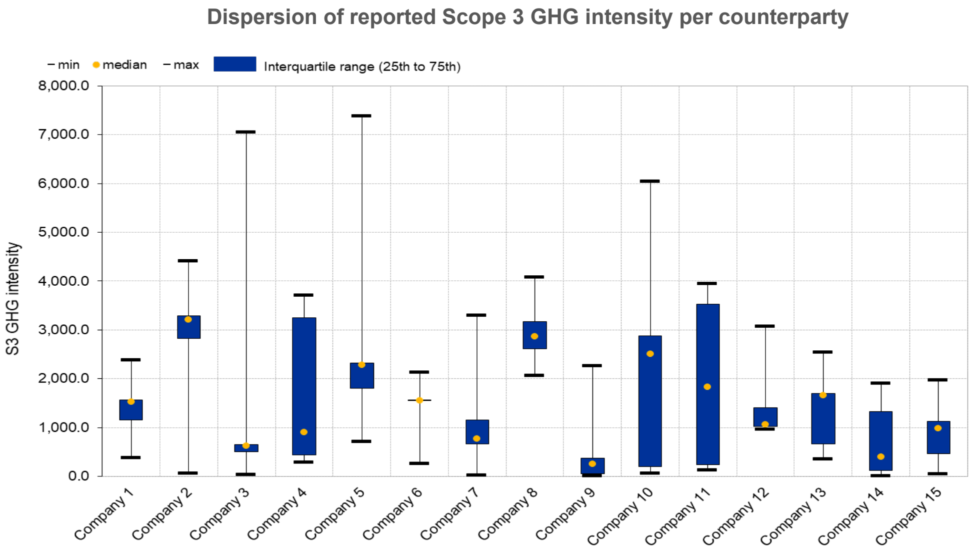
MODULE 2

More than half of **banks' income from non-financial corporate customers** comes from greenhouse gas-intensive industries.

Reported sectoral income is a **significant advancement for climate discussions.**

Banks **lack actual data** regarding GHG emission availability. Around 70% of the reported S1,S2, S3 emission rely on **proxies**.

Proxies are a good first step, but they can **create deviations** in the results.



Main findings: 2022 Climate risk stress test

MODULE 3

Banks don’t have **robust long term strategies** and show little differentiation between different possible long-term scenarios.

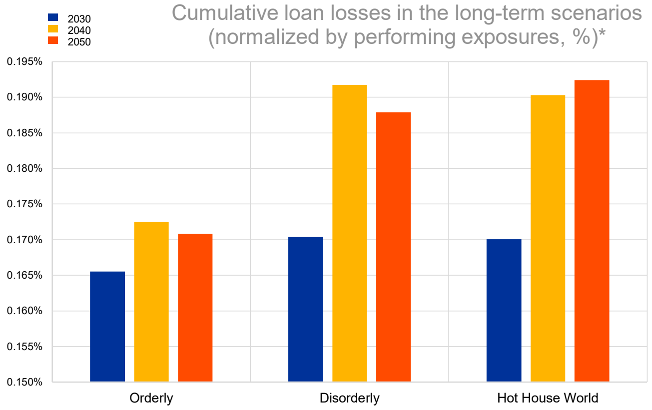
Results show that an **orderly green transition will lead to lower loan losses** than a disorderly or inactive one.

Credit and market losses amount to around **€70 billion on aggregate for the 41 banks** in the short-term disorderly transition and the two physical risk scenarios.

However, **this understates the actual climate-related risk** owing to:

- The scarcity of currently available data
- The banks’ modelling only capturing climate factors rudimentarily
- The exclusion of economic downturns from the scenarios
- The included exposures only account for around one-third of the total
- Lack of supervisory overlays

Banks **were unable to allocate 17%** of the reported collateral to an Energy Performance Certificate bucket, **even using proxies**.



* Data refer to the 41 projecting banks only.

Lessons learnt

Banks:

Managed to report **comprehensive and innovative information** on their climate risk stress test capabilities

Face **significant challenges** in data availability and modelling techniques

Supervisors:

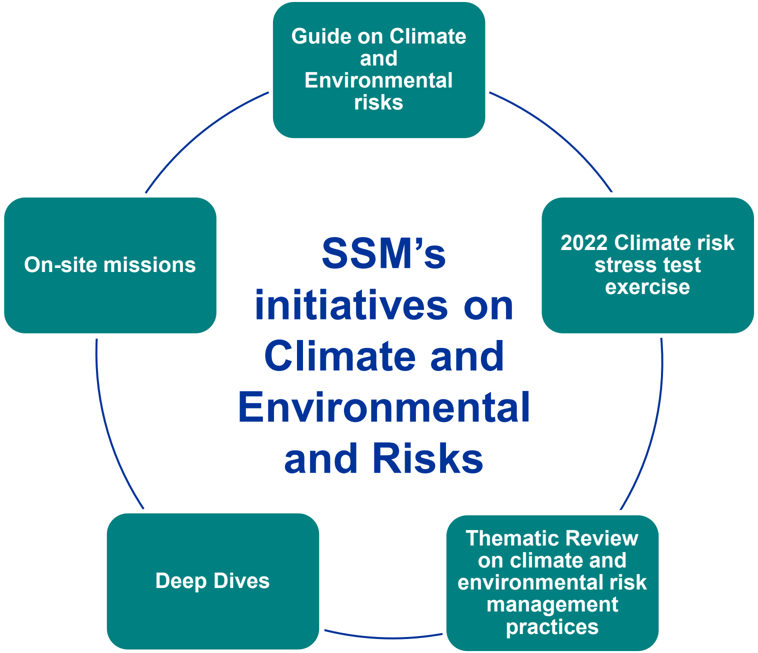
Gathered **valuable insights** into banks capabilities and vulnerabilities

Need to:

- **Enhance methodological approaches and bottom-up stress scenarios**
- Help banks overcome **challenge of data availability**
- Provide guidance on **"best practices"**

Results integration into SREP

- The 2022 climate stress test exercise is part of a **broader set of ECB activities** to assess banks' level of preparedness to properly manage climate risk.
- This results will feed into the **SREP from a qualitative approach**, and there will be no direct capital impact the Pillar 2 guidance this year.
- All participating banks have received **individual feedback** and are expected to take action.
- The **ECB plans to publish guidance on best practices in the last quarter of 2022**.



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