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.*
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**.
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**.
Climate Risk Stress Test 2022

Final Results

8 July 2022

Frank Elderson, Vice-Chair of the ECB Supervisory Board