Information on participation in the 2022 ECB Climate Risk Stress Test

Dear Sir/Madam,

As a competent authority, the European Central Bank (ECB) carries out supervisory stress tests on the banks it supervises at least annually. As previously communicated to and discussed with the industry, the ECB will be conducting a stress test on climate-related risks in 2022, to be called the 2022 ECB Climate Risk Stress Test (CST).

The ECB considers this stress test to be a learning exercise for banks and supervisors alike. It 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. The stress test comprises three distinct modules:

Module 1 – An overarching questionnaire to assess how banks are building their climate stress test capabilities for use as a risk management tool. 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. These metrics include how much banks rely on income from carbon-intensive industries and what volume of greenhouse gas emissions banks finance. 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. 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 ECB intends to keep this exercise meaningful while not unduly burdening banks with reporting requirements they are at present unable to meet. In that spirit, 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. This ensures that the CST remains a useful learning exercise, tailored both to supervisory needs to identify relevant risks and to banks’ different levels of preparedness.

Your institution has been selected to participate in Module(s) [1 / 1 and 2 / 1, 2 and 3]. Please find the Methodological Note for the 2022 CST attached to this letter.

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.

The abovementioned activities of ECB Banking Supervision complement the activities of the central banking side of the ECB in this area. The scenarios of the 2022 CST will be based on the ECB economy-wide climate stress test of 2021.

We are looking forward to further constructive exchanges and fruitful collaboration on the topic of climate risk.

Yours sincerely,

[signed]
Stefan Walter

[Note: This letter is an adjusted version of the specific working instructions sent to individual banks.]