eba | European Banking Authority

Public Consultation:
Guidelines on ESG Scenario Analysis

Public Hearing, 17 March 2025

HOUSEKEEPING RULES

- *Please remain on mute when not speaking.*
- *If you have a question, please raise your hand and wait for the organizer to give you the floor.*
- *Please make sure to turn your microphone off after your intervention.*
- *In case of IT issues, please try to log out and reconnect again.*

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Legal mandate

Public Hearing

01 - Legal mandate & Integration in the regulatory framework

Legal mandate

- In conjunction with GL on the management of ESG risks, GL on ESG scenario analysis aim to meet the mandate from **Article 87a(5) of CRD6**
- They are also intended to fulfil the mandate from **Article 177 of CRR3**

Integration in the regulatory framework

- GL on ESG scenario analysis are complementary to 2018 **GL on Institutions' Stress Testing**
- They build upon the **Business Model Analysis (BMA) methodology** of SREP GL

01 - Legal mandate & Integration in the regulatory framework

Objective

Support banks in **testing** their **resilience** to the negative impacts of ESG factors through the use of scenarios

Scope

Focus on **climate-related risk**

Institutions should progressively broaden the spectrum to other ESG risks

Proportionality

Emphasis on **materiality assessment**

Maturity of the topic taken into account

Size & complexity of activities also considered

Consistency

With other **EBA** products (on ESG risks or stress testing)

With **BCBS** work on scenario analysis

With **EU initiatives** (incl. CSRD, CSDDD)

02

Contents of the guidelines

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02 – Overall approach:

Considering that ESG scenario analysis is…	• still in its very infancy • operationally not mature • fast-evolving
The proposed approach is to…	• start with a narrowly defined scope • focus on high-level requirements • consider revision in the near /medium term

02 – The backbone of the Guidelines

A FORWARD-LOOKING APPROACH…

Use of Climate Scenario Analysis (CSA) to test bank's resilience

Climate Stress Testing (CST)

Test bank's financial resilience

- Limited to a rather short-term horizon (less than 5 years)
- Under Reasonable Uncertainty – hypotheses not forecasts
- Using a baseline & adverse but plausible scenarios
- Through a static or dynamic balance sheet approach, including the changes from the transition plan
- Considering indirect effects and seeking consistency between counterparty and macro level

➲ **To measure financial impacts**
➲ **To check capital & liquidity adequacy**

Climate Resilience Analysis (CRA)

Challenge bank's business model resilience

- Encompassing a long-term horizon (at least 10 years)
- Under Deep Uncertainty – hypotheses not forecasts
- Using a central scenario & a set of distinct scenarios
- Through a dynamic (balance sheet) approach
- Leveraging sectoral trajectories and counterparty transition plans

➲ **To assess compatibility with global warming of 1.5°C**
➲ **To check robustness of the business model**

…TO PREPARE FOR A WORLD IN TRANSITION

02 – The contents of the Guidelines

The Guidelines on ESG Scenario Analysis are divided into 3 sections

<u>Section 1</u>: Scenario analysis, an integral part of risk management and strategic process

- Purpose and governance
- Proportionality and learning curve

<u>Section 2</u>: Steps for scenario analysis

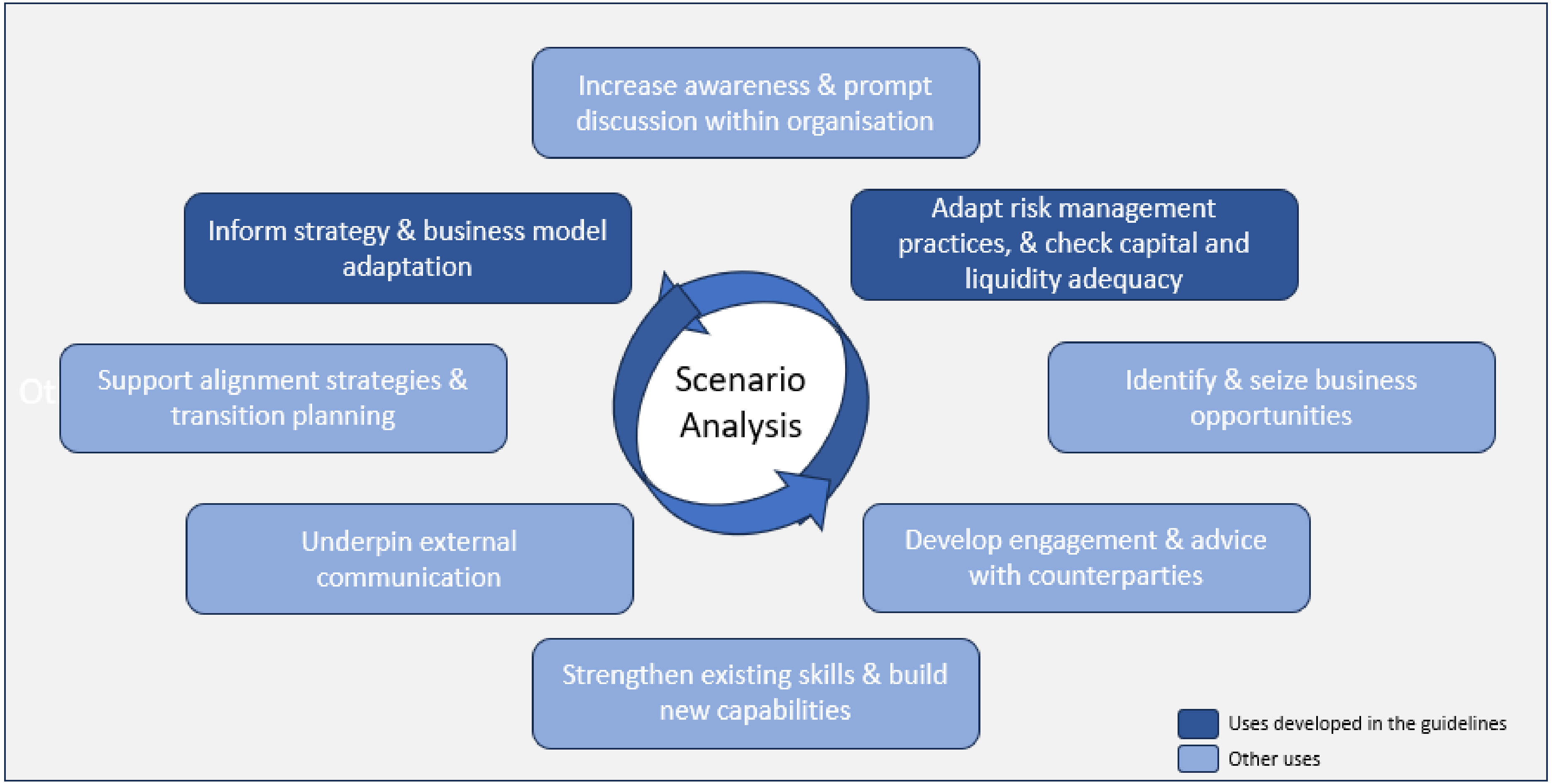
- Setting climate scenarios
- Defining climate transmission channels

<u>Section 3</u>: Scenario development processes and use in decision-making

- Testing financial resilience through Climate Stress Tests (CST)
- Challenging business model resilience through Climate Resilience Analysis (CRA)

<u>NB:</u> Climate is used as a guiding first step before expansion to other ESG risks as process matures

Section 1.1: Purpose and governance



Section 1.2: Proportio-nality and learning curve

All banks

Not material — **Materiality of risks** — Material

Not mature — **Maturity of the approach** — Mature

According to the bank's size and complexity

Simplified — **Sophistication of the approach** — Comprehensive

SNCI may rely on predominately qualitative approaches

Section 2.1: Setting climate scenarios

In terms of **narratives and scenarios**, banks need to

- Adopt a clear and regularly updated narrative used consistently throughout the bank
- Develop a **central scenario** (i.e. bank's most likely scenario) based on this narrative
- Consider both transition and physical risks, consider combining climate risks with other macroeconomic risks
- Use credible, science-based scenarios, **leveraging the scenarios developed by widely-recognised organisations**
- Refine the scenarios according to the bank' specific features
- For CST, use a baseline scenario & adverse, plausible scenarios
- For CRA, use a central scenario & alternative, distinct scenarios
- Ensure consistency of the scenarios used
- Keep abreast to latest developments

Section 2.2: Defining climate transmission channels

Climate Risk Drivers

Climate Transition Risk

Microeconomic channels

- Unprofitable or overly indebted corporate due to lack or partial transition
- (Near) stranded assets
- Legally liable corporate
- Higher running costs for households

Macroeconomic channels

- Change in energy mix, price and use
- Significant shift in prices
- Productivity changes
- Labor market frictions
- Changes in consumer and market preferences
- International trade, government revenues,...

Climate Physical Risk

Microeconomic channels

- Lower corporate profitability due to disruptions or growing physical stress
- Households' income & health affected by shocks or gradual deterioration of physical conditions
- Property damage
- Increasing adaptation costs

Macroeconomic channels

- Knock-on effects to economies
- Significant shift in prices
- Reduced workforce productivity
- Supply chain disruptions & resource scarcity
- Migrations and displacements...

Sources of variability

Geographic / Sectoral heterogeneity

- Exact location
- Vulnerabilities and dependencies

Amplifiers / Mitigants

- Risk drivers' interactions
- Banks reactions
- Availability and pricing of insurance
- Adaptative capacity of counterparties
- Availability of hedging solutions

Business model risk / Credit risk / Market risk / Liquidity risk / Operational risk

Section 3.1: Climate Stress Tests (CST)

When carrying out **Climate Stress Tests (CST)**, bank should

- **Apply** the requirements of **the GL on Institutions' stress testing** and of the ICAAP / ILAAP methodology
- On the basis of a thorough gap analysis of the models, identify and **adapt modelling capabilities** to adequately incorporate climate risks
- Ensure an appropriate **level of granularity** within their models, incl. sectoral and geographical and where possible counterparty/asset level
- Adopt a static or dynamic **balance sheet approach**, consider including the main changes stemming from the bank's approved strategy / transition plan
- Consider applying **additional stress factors** based on expert judgment to address the residual models' shortcomings
- Identify and implement **management actions** as provided for in the GL on stress testing (incl. reassessing capital adequacy) & the GL on the management of ESG risks

Section 3.2: Climate Resilience Analysis (CRA)

When carrying out **Climate Resilience Analysis (CRA)**, bank should

- Conduct a **detailed analysis of the environment** in which bank operates and its key drivers of change at sector / country crossover level (incl. feedback loops and financial sector role in financing the transition)
- Draw up a detailed **map of the bank current sources of profitability**
- Based on the bank's central scenario, make **approximate projections** for its various activities over several time horizon (**incl. 10 years**) and ensure that the projections comply with the targets set in its plan
- Reproduce projections for alternative scenarios**, incl a high emission and 1.5C scenario**
- Leverage the work on portfolio alignment (cf. GL on the management of ESG risks
- Support the analysis with sound **expert judgement**
- **Adapt strategy and business model** on the basis of the CRA's findings

03

Next steps

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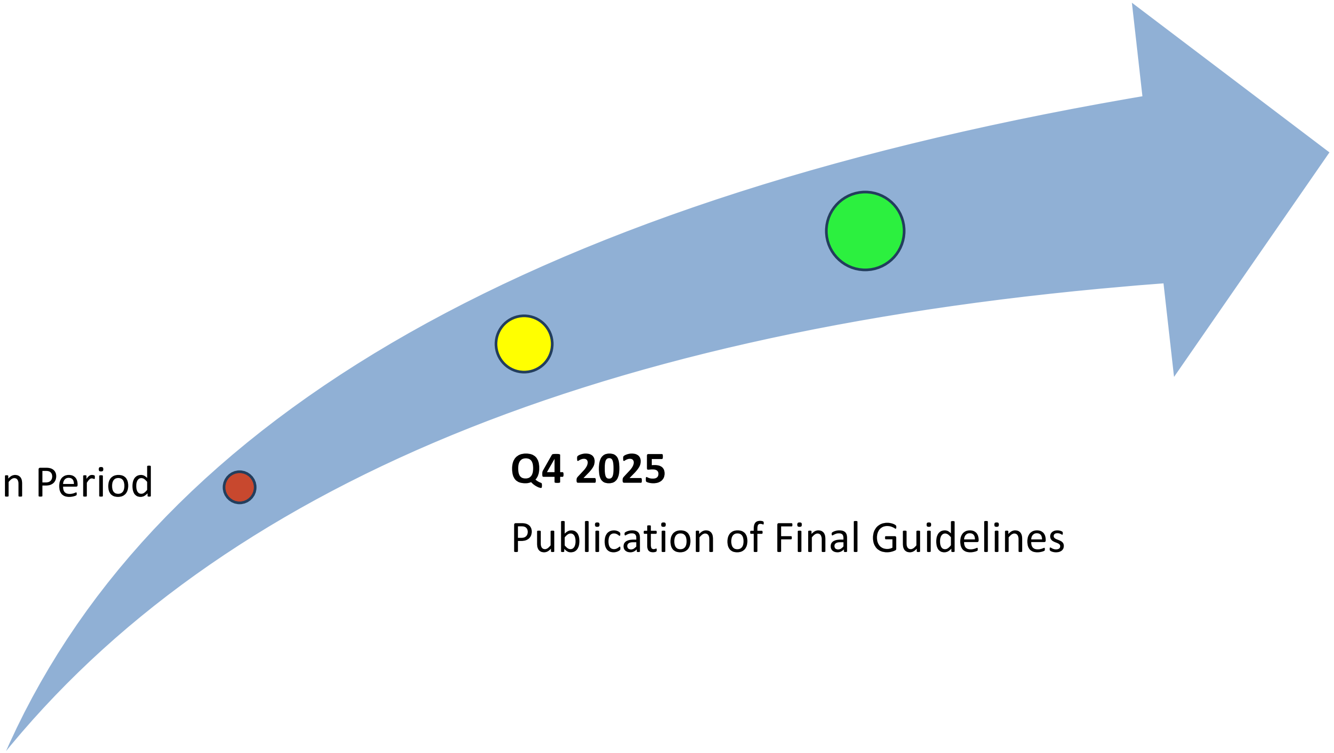
03 - Next steps



16 April 2025

End of the Consultation Period

Q4 2025

Publication of Final Guidelines

2026?

Application date

=> Need to be further discussed

04

Questions & Answers Session

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04 – Questions & Answers

Thank you!

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